A REGULATORY FRAMEWORK FOR ENTRY INTO AND OWNERSHIP OF THE ONTARIO SECURITIES INDUSTRY

A Report of the Ontario Securities Commission
to the Minister of Consumer and Commercial Relations

ONTARIO SECURITIES COMMISSION

February 1985

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ONTARIO SECURITIES COMMISSION

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February 14, 1985

The Honourable Gordon Walker, Q.C.
Minister of Consumer and Commercial
Relations
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Dear Mr. Minister:

I am pleased to deliver to you the Report of the Ontario Securities Commission entitled "A Regulatory Framework for Entry Into and Ownership of the Ontario Securities Industry". The Report was prepared in response to a number of developments in the capital markets and the recommendations contained in the Report have important implications for all users of the capital markets. We respectfully request your early consideration of the Report and the implementation of the recommendations as soon as is reasonably possible. I am, of course, available to you at any time to discuss the contents of the Report.

Yours very truly,

Peter Dey

Peter J. Dey
Chairman

A REGULATORY FRAMEWORK FOR ENTRY INTO AND OWNERSHIP OF THE ONTARIO SECURITIES INDUSTRY

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SUMMARY

A number of developments in the capital markets have raised the question of the adequacy of the current regulatory framework concerning entry into and ownership of the Ontario securities industry. These developments include increased interest of Canadian issuers and investors in offshore markets and increased activity by offshore securities firms in Canadian capital markets; increased competition among financial institutions to offer a broader range of financial services, some of which involve limited intermediation activities in securities markets, and the re-emergence of financing practices such as "bought deals".

In response to these and other developments, a debate emerged as to the adequacy of the capital of the industry, with some arguing that the industry was adequately capitalized to serve Canadian issuers and investors and others arguing that the industry was not adequately capitalized and that improved access to capital could lead to more efficient capital markets. The traditional sources of capital for the industry have been earnings, subordinated loans and, in particular, equity investment by the individuals who work in the industry.

Outside investment in the securities industry has been regulated in differing ways for many years. The Government's policy concerning participation by non-residents in the domestic securities industry was stated by Premier William Davis on July 13, 1971: "We believe it to be essential that ownership of investment companies remain substantially Canadian." The laws regulating non-resident involvement in the capital markets have been in place since that date. The Securities Act of Ontario is silent on the question of involvement by financial institutions and by

other commercial enterprises in the securities industry. The involvement of the latter is, however, dealt with in the by-laws of the self-regulatory organizations within the Commission's jurisdiction.

As part of its mandate to administer the Securities Act in the public interest, the Commission has continued to monitor and participate in the debate concerning outside involvement in the securities industry.

In developing our recommendations on these matters, we started with the conceptual premise that the free market should determine the availability of financial services; the only restrictions that should be imposed upon the free market should reflect overriding public policy objectives and should be the minimum restrictions necessary to achieve these objectives.

From this perspective, the Commission determined that there are basically two overriding public policy objectives which must be preserved, that is to say:

1. it recognizes the Government's policy that ownership of securities firms must remain substantially Canadian; and

2. it recognizes that as a matter of public policy the financial system should be organized into "four pillars", with each group of participants in the financial system, i.e. banks, trust companies, insurance companies and securities firms, providing distinct services.

In analyzing in this manner the issues that have arisen, we have concluded that the basic issue is not adequacy of capital but access to capital. The model for regulating entry into the securities industry recommended by the Commission results in more relaxed ownership restrictions and therefore should improve access for securities firms to capital.

The following is a summary of the key provisions which would apply to entry into the securities industry and ownership of securities firms under the Commission's model if it were adopted:

1. **Investment by Non-residents.** Non-residents, including a single non-resident, may own up to 30% of the participating securities and voting securities of a securities firm registered in Ontario, provided that if non-residents in the aggregate own more than 10% of such securities the securities firm must have one significant industry investor owning in excess of 50% of the participating and voting securities.

2. **Direct Entry by Non-residents.** The Commission will issue a notice inviting applications for a new category of registration - the foreign dealer registration - for firms owned more than 30% by non-residents. There will be a limit imposed upon the aggregate capital of the firms registered in this category as well as a limit upon the capital of each of these firms. The aggregate limit will be not more than approximately 30% of the capital of the industry and the individual firm limit will be not more than approximately 1.5% of the capital of the industry. The registrations will be allocated by the Commission, having in mind a number of factors, including the services to be offered in the Canadian marketplace. This category of registrant is intended to be available to Canadian subsidiaries of securities firms based in other jurisdictions.

A non-resident financial institution carrying on business as such in Canada would not be eligible for a registration in this category.

3. Grandfathered Non-resident Firms. The three remaining non-resident securities firms which were grandfathered from the 1971 rules restricting non-resident ownership will be regulated as foreign dealer registrants. They will have individual capital limits imposed by the Commission which may exceed the 1.5% maximum limit for other foreign dealer registrants.

4. Access of Domestic Investors to International Markets. A separate code of regulations is proposed to facilitate access by Canadian issuers and investors to offshore capital markets. A new class of registration - international dealer registration - will be available without ownership restrictions to non-resident firms seeking to deal with Canadian retail investors wishing to invest in foreign securities.

5. Investment by Financial Institutions. The 30% limitation coupled with the requirement for the significant industry investor applicable to investment by non-residents in Canadian securities firms will also apply to investment by financial institutions. Accordingly, financial institutions, including a single

institution, may own up to 30% of the participating securities and voting securities of a securities firm registered in Ontario, provided that if financial institutions in the aggregate own more than 10% of the securities, the firm must have an industry investor owning more than 50% of the participating and voting securities.

6. Investment by Others. Investment by investors, other than industry investors, non-residents and financial institutions, is regulated in a manner similar to investment by non-residents and financial institutions with one important exception. "Others" can own up to 49% in the aggregate but as with non-residents and financial institutions, any one "other" is limited to 30% and the requirement for the significant industry investor is triggered when "others" own, in the aggregate, in excess of 10% of the voting or participating securities.

7. Universal Registration for the Protected Functions. Only registrants will be able to act as underwriters and full service brokers, whether in the regulated market or the exempt market in corporate securities. For this purpose, registration exemptions for $97,000 private placements, specified financial institutions and exempt purchasers will be removed for underwriting and full service brokerage in corporate securities. Trading in government securities will not be affected by this provision.

8. Registrations Outside the Protected Functions. The Commission will have the discretion to grant registrations to financial institutions and others seeking to provide a service requiring a dealer registration under the Act, provided that the Commission is satisfied that the provision of the services will not materially impair the performance of the protected functions by the securities industry.

9. Advisers. Ownership and entry restrictions will not be applicable to advisers.

10. SRO By-laws. The by-laws of The Toronto Stock Exchange and of the Ontario District of the Investment Dealers' Association of Canada would have to be amended so as not to conflict with the ownership and entry restrictions recommended in this Report.

11. Immediate Implementation. This model is recommended to the Government for immediate implementation. The Commission will monitor the operation of the model and will monitor other developments in the organization of the financial system on an ongoing basis.

A REGULATORY FRAMEWORK FOR ENTRY INTO AND OWNERSHIP OF THE ONTARIO SECURITIES INDUSTRY

INTRODUCTION

PART I

1.01 Testing the Financial System. The regulatory structure within which capital markets function in Canada, like the regulatory structures within which other major world capital markets function, is being tested by a variety of recent developments. Financial institutions are testing the limits of their governing legislation and the limits of securities legislation by directly entering the capital markets and offering services traditionally offered by securities firms. By the same token, some securities firms are arranging with financial institutions to distribute products and services of the institutions, thereby rounding out their packages of financial services. The so-called "four pillars" organization of the Canadian financial system, with separate groups of financial institutions offering distinct financial products and services, is undergoing much scrutiny and debate in a number of quarters.

1.02 Developments in the Domestic Marketplace. There are other developments in the domestic markets not involving financial institutions which are affecting the composition of the industry. For example, the deregulation of commission rates has introduced significant price competition into the secondary market. The re-emergence of "bought deals" has upset traditional underwriting relationships, resulted in the development of arrangements to backstop undersold deals, and increased the amount of capital required to carry on a full service securities business. Recent mergers of various securities firms may be symptomatic of these and other developments in the marketplace.

1.03 International Pressures on the Marketplace. The pressures on the marketplace are not just domestic. Major Canadian issuers do not finance without considering the financing opportunities in offshore markets. These issuers are being aggressively serviced by multinational securities firms which operate in Canada out of suitcases or out of correspondent offices which purport not to engage in any trading in securities except with institutional investors. Similarly, Canadian investors are becoming increasingly interested in investing in securities in offshore markets. This interest arises from many factors, such as the need to diversify investment risk geographically, limited Canadian product and so on. Many of these investors deal directly with securities firms located outside Canada. Although a few Canadian firms have a significant presence internationally, Canadian issuers tend to be served by non-resident firms based in London and New York. There is a lot of "street talk" about the business plans of other major Canadian firms which are intent upon acquiring a share of the market for Canadian financing outside Canada. A principal determinant for a securities firm contemplating an expansion of the nature of its business or a geographical expansion is the source and amount of capital available to it.

1.04 The Importance of Capital. The capital of a securities dealer determines to a large extent the nature and scope of the dealer's business. A minimum level of capital is required for regulatory purposes, the amount depending upon the liabilities to be incurred. Expenses for information and transaction systems and physical premises also require significant capital. Perhaps most important is the judgment of the dealer as to the amount of capital which should be available before the dealer assumes any given liability.

1.05 Sources of Capital. There are generally three sources of capital available to a securities dealer, (i) equity investment, (ii) retained earnings, and (iii) funds advanced by lenders, the repayment of which is subordinated to the claims of clients of the dealer. Securities regulation affects only indirectly the earnings of a securities firm and the availability of funds from lenders. Securities regulation does, however, directly affect the sources and amount of invested capital. The conditions of registration under the Ontario Securities Act (the "Act") and the by-laws of the self-regulatory organizations ("SROs") impose restrictions on the persons and companies that can invest in a securities firm. These restrictions also determine such basics as who can control a securities firm and who can enter into the securities business.

1.06 Traditional Sources of Capital. The rules which define the sources for funds which may be invested in a securities firm are found in the Act, the Regulations under the Act (the "Regulations") and in the by-laws of the SROs for those firms which are members of the SROs. The SROs are the stock exchanges in Canada and the Investment Dealers' Association of Canada (the "IDA"). Under the rules of the SROs, the traditional source of invested funds is the officers and employees of the securities firm. (For the time being, we will use the term "industry investor" to refer to officers and employees, although this term is commented upon later in the Report.)

1.07 Merrill Lynch and Royal Securities. Until the early 70's, outside sources of invested capital were not an important issue in securities regulation. However, the Ontario Securities Commission (the "OSC" or the "Commission") and the SROs in Canada became concerned with the issue of non-resident investment in Canadian securities firms with the aquisition in 1969 of Royal Securities Corporation Limited by a wholly-owned Canadian subsidiary of Merrill, Lynch, Pearce, Fenner and Smith Inc.

Reports for both the SROs and the OSC[1] provided the basis for the provisions in the Regulations controlling the extent of the involvement of non-residents in the Canadian securities industry from 1971, when they were enacted, to the present.

1.08 Non-resident Ownership Restrictions Summarized. The ownership restrictions applicable to non-residents apply as a condition of registration. Registration is not available if non-residents in the aggregate beneficially own or control more than 25% of a class of the firm's securities or if a single non-resident beneficially owns or controls more than 10% of a class of its securities. These rules have effectively closed the door on any new non-resident entrants to the industry in Ontario. These ownership restrictions were not mirrored in the by-laws of the SROs until 1982.

1.09 The Grandfathered Non-resident Dealers. At the time of the imposition of these non-resident ownership restrictions in 1971, 26 firms registered as dealers did not comply with the ownership restrictions applicable to non-residents.[2] These firms were grandfathered from the non-resident restrictions upon certain conditions. Eight of the grandfathered firms were members of SROs. Of the eight

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[1] See Report of the Committee to Study the Requirements And Sources of Capital and the Implications of Non-Resident Capital for the Canadian Securities Industry, May 1970, (often referred to as the "Moore Report"), a Report prepared for the Investment Dealers' Association of Canada and the stock exchanges of Canada. See also Report of the Securities Industry Ownership Committee of the Ontario Securities Commission, April 1972 (the "1972 Commission Industry Ownership Report").

[2] See Appendix "C" of Report to the Minister of Consumer and Commercial Relations on the Application of Ontario Securities Legislation to Non-resident Securities Firms Not Currently Registered in Ontario, November 29, 1979 (the "Suitcase Brokers Report").

only three survive.[3] The grandfathered dealers are subject to a code which ensures that they cannot grow at a rate faster than the average rate of growth of the major Canadian firms - the money market dealers. The code also prohibits these firms from obtaining new capital from their parents and requires them as a condition of continued registration to obtain the approval of the Commission for a material change in ownership. In 1971 the eight grandfathered firms which were members of The Toronto Stock Exchange (the "TSE") represented some 12% of the capital of all TSE members. At December 31, 1984 the comparable figure was approximately 9%. By imposing the constraints on growth and change of ownership, the code applicable to the grandfathered firms has operated to reduce their involvement in the capital markets.

1.10 The Grandfathered Advisers. Of the six registrants in the category of adviser grandfathered in 1971, three have surrendered their registrations, two are now Canadian owned and one remains owned by non-residents. In addition, the Commission has issued orders exempting five registrants in the category of adviser from the non-resident ownership restrictions[4]. These orders generally reflect the Commission's view that non-resident advisers do not have advantages over resident advisers comparable to the advantages of non-resident dealers over resident dealers and also that there is a need to increase the sources of investment advice available to the Canadian investing public on certain conditions.

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[3] See Appendix 1 which describes the current status of the 26 grandfathered registered dealers.

[4] See Appendices 2 and 3, respectively, for information concerning the current status of grandfathered advisers and for a current list of non-resident advisers.

1.11 Other Regulation of Outside Involvement in the Securities Industry. The Act is silent on the ownership of securities firms by financial institutions and other non-industry investors. Until 1982 the TSE, the only stock exchange carrying on business in Ontario, addressed the issue of ownership of members by non-industry investors through the general requirement contained in the by-laws for the approval by the TSE of all investors in SRO members. As a general matter, approval would not have been given for a significant investment in a member by a financial institution. In 1982, the TSE enacted by-laws which limit a single investor, other than an industry investor, to owning securities carrying no more than 10% of the votes and 10% of the outstanding participating securities of a member corporation. Under this by-law it is possible for 10 non-industry investors each owning 10% of any class of securities of a dealer to own 100% of the dealer. There is no limit on the aggregate equity of a dealer that may be owned by non-industry investors. In addition, the by-laws require that 40% of the directors or partners of a member are to be industry members. At the same time the TSE approved a by-law which would allow any member corporation to raise capital by way of a public offering, provided that the member was organized in such a manner as to comply with the ownership restrictions referred to above.

1.12 Commission Policy on Public Ownership. For its part, the Commission in Policy 4.1 announced its willingness to consent to a preliminary prospectus filed by a dealer in respect of securities of its own issue, provided that the dealer complies with the following requirements. The Policy requires that, except with the respective consents of the TSE or IDA or both if the dealer is a member of either or both SROs, the dealer must take steps to ensure that no single new investor who is not an industry investor will own more than 10% of any class of voting or participating securities of the dealer. The dealer must also take steps

to ensure that 40% of its directors are Canadians, obtain the approval of the OSC and the SROs for the balance of its directors, and refrain from diversifying into other sectors of the financial services industry.

1.13 Four Publicly Owned Securities Dealers. Four dealers have taken advantage of the provisions in the SRO by-laws and the Commission Policy to raise approximately $23 million through public offerings. Details concerning the public distribution of securities by dealers are set out in Appendix 4.

1.14 Non-industry Investment in Securities Dealers. The Report of the Joint Securities Industry Committee[5] states that one SRO member (apart from four firms controlled by U.S. parents) has issued more than 10% of its voting securities to a non-industry investor. The Commission is also aware of other firms which have attracted investments from non-residents and financial institutions which are just under the 10% ceiling.

1.15 The Exempt Market. A number of firms which do not comply with these ownership restrictions limit their business to what has been referred to as the "exempt market". The exempt market is the market in those transactions in securities which are effected pursuant to exemptions from the registration requirements of the Act. The exemptions relate both to securities and trades. Exempt securities include commercial paper, and debt securities issued or guaranteed by a government, a chartered bank, a trust or loan corporation or an insurance company. Exempt trades include trades where the party purchasing as principal is a chartered bank, a trust or loan corporation, an insurance company, or a company recognized by the

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[5] See Paragraph 1.25.

Commission as an exempt purchaser, and trades in securities which have an aggregate acquisition cost to the purchaser of not less than $97,000. A market intermediary operating in the exempt market is not subject to the registration requirements under the Act and accordingly is not subject to the restrictions on registration, such as the ownership requirements.

1.16 The Regulated Market. The market in securities transactions, other than the transactions in the exempt market, i.e. everything else, is referred to as the regulated market.[6] Regulated, because the transactions in this market cannot be effected without compliance with the registration requirements of the Act. For example, the conventional public offering of securities is a transaction in the regulated market requiring the offering to be made through a prospectus by a registrant. Any person acting as a dealer or underwriter in the regulated market is subject to conditions of registration and, therefore, ownership restrictions.

1.17 Ownership Restrictions Determine Participants in the Capital Markets. The rules regarding ownership of securities firms, whether found in the Regulations to the Act applicable to registrants or in the by-laws of the SROs applicable to their members, determine who participates in the capital markets and the extent of their participation. This Report focusses on "outside involvement" in the securities industry.

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[6] The reference to "regulated market" should not give rise to the inference that the exempt market is unregulated. The Commission has the power in section 124 of the Act to remove or condition the exemptions which constitute the basis for the exempt market.

1.18 Outside Involvement in the Securities Industry. By outside involvement, the Commission means (i) investment in securities firms and (ii) direct participation in the capital markets, by persons and companies other than industry investors. We have broken down outside participants into three categories:

(i) resident financial institutions, i.e. trust companies, life insurance companies, banks, credit unions, and other similar financial institutions,

(ii) resident investors other than financial institutions and other than industry investors ("other resident investors") and

(iii) non-resident investors, whether they are securities firms, financial institutions or others.

For purposes of this Report, the persons and companies in these categories will include both their associates and affiliates as those terms are defined in the Act, as well as persons or companies acting jointly or in concert with them. For example, an investor which is an other resident investor which owns more than 10% of a resident financial institution would, for purposes of the Commission recommendations, be considered to be a resident financial institution. The tests used in the Regulations to define a "non-resident", i.e. a person who is not a Canadian citizen, a person not resident in Canada, a company incorporated outside Canada, and so on, will be relied on for purposes of the Commission model.

1.19 General Concerns of the Commission. The study resulting in this Report was motivated by a general concern of the Commission that the Regulations governing outside involvement are not evolving on a comprehensive basis and that the regulatory framework now in place requires reconsideration to determine whether the policies it reflects are still appropriate in the marketplace today.

1.20 The Gordon Capital Proposal. General concern about the possibly outmoded regulatory framework was heightened by a proposed reorganization of Gordon Capital Corporation (then Daly Gordon Securities Limited) that was presented first to the TSE and the IDA. The proposal is useful for our purposes in underlining the concern expressed above because it exposes certain aspects of the regulatory framework which patently require review. The proposal involved dividing Gordon Capital into two separate corporations, with different ownership structures. One corporation would have operated in the regulated market and the other would have operated in the exempt market. The regulated part of the business would have been subject to the registration requirements of the Act and therefore would have been subject to the conditions of registration imposing limits upon ownership by non-residents. It would also have been a member of the SROs and therefore would have been subject to ownership limitations in the by-laws of the SROs not only applicable to non-residents, but also applicable to financial institutions. The exempt part of the business would not have been subject to these ownership restrictions because it would not have been registered under the Act and would not have been a member of the SROs. The exempt part could then have been capitalized in part by an investment from a non-resident financial institution - an investment which would have been prohibited if made in the regulated part of the business.

1.21 Appeal to the Commission. The proposal came to the Commission by way of request for a hearing and review of the decision of the Board of Governors of the TSE refusing approval for the proposal. The Commission indicated to Gordon Capital that the proposal raised questions which warranted a more general study of the framework relating to ownership of securities dealers before the proposal could be properly addressed. Gordon Capital agreed that the hearing of its appeal be deferred pending the outcome of this study.

1.22 Questions Raised By the Proposal. Questions raised by the Gordon Capital proposal include the following:

(i) What is the regulatory concern underlying the ownership restrictions in the Act applicable to non-residents and underlying the ownership restrictions in the by-laws of the SROs applicable to financial institutions?

(ii) The regulatory concerns underlying the ownership restrictions in the Regulations to the Act and the by-laws of the SROs can effectively be avoided if persons and companies carry on a securities business but confine the business to the exempt market. Is this contrary to the public interest? Or, put another way, is attaching ownership restrictions to registration under the Act an effective regulatory tool for dealing with the concerns underlying the restrictions, when extensive activities in the capital markets can be carried on without registration? The same question can be asked concerning membership in the stock exchanges, particularly when it is possible to carry on a brokerage business without an exchange membership because of such regulatory changes as the deregulation of commission rates.

(iii) Are the current ownership restrictions applicable to non-residents and financial institutions the most effective way of meeting the regulatory concerns referred to in (i)? Or, do the present restrictions operate to deny Canadian dealers access to capital and other resources to such an extent that the efficient functioning of the capital markets is unnecessarily inhibited?

(iv) By implication, the question is raised whether the regulatory framework for the domestic capital markets erects barriers to access by Canadian issuers and investors to international markets which are unnecessary and which could be relaxed without impairing the efficiency of the domestic market.

1.23 Subsidiary Questions. Subsidiary questions arise out of these general questions, such as, is there a need to conform the rules of the SROs and the requirements of the Act? Should the Act expressly address the question of ownership of securities firms by financial institutions and indeed other investors who are neither financial institutions nor industry investors?

1.24 Premises and Structure of the Study. The Commission thought that these were important questions which could only be answered with the opportunity for input from participants in the capital markets. In defining the scope of the study, the Commission has accepted two overriding principles of public policy:

(i) The Commission accepts the following statement made by the Premier to the Legislature on July 13, 1971 as the policy of the Ontario Government concerning non-resident involvement in domestic capital markets:

> "We believe it to be essential that ownership of investment companies remain substantially Canadian."

The Commission also accepts as an elaboration of the Government's policy in this area the statement made in the 1972 Report of the Industry Ownership Committee of the Commission, a Report requested by the Premier at the time of his 1971 statement:

> "We must be zealous to ensure that there is vital and innovative competition in the securities industry. To this end we do not believe it to be in the public interest to provide Ontario firms with protection from the innovative and efficient practices suggested for the foreign-controlled firms. We are concerned, however, that the marketplace should not be dominated by foreign-controlled firms. We wish to encourage and strengthen Canadian firms by permitting them to seek outside capital. In being fair to the existing non-resident firms, we wish to permit them to grow on a rational basis while at the same time, guarding against their obtaining a position of undue dominance."

(ii) The Commission also accepts for purposes of this study the premise that the Canadian financial system should be organized on a segregated basis with each group of financial institutions performing a separate function, the so-called "four pillars" principle. This principle is accepted, not because of any specific statement of Government policy, but because it is generally reflected in the legislation governing financial institutions. It is also a principle which the Commission has not studied as such, except as it impacts the question of who should participate in the capital markets and on what terms. The acceptance of the principle in this study is consistent with the approach of the Commission in the Report on the Implications for Canadian Capital Markets of the Provision by Financial Institutions of

Access to Discount Brokerage Services (the "Discount Access Report"). As is well known, the principle is being studied at both the provincial and federal levels of government in Canada.

In carrying out its study, the Commission took the following steps:

(i) The Commission decided that it was essential to have the participation of the securities industry in the study and that the industry should be asked to provide the first regulatory model addressing the issues under consideration - a model to which other participants could respond.

(ii) The Commission announced the study in a series of notices which are attached as Appendix 5 and invited briefs from interested parties.

(iii) The Commission, based upon its experience in preparing the Discount Access Report, designed a format for the public portion of the study which ensured that sufficient time for oral submissions would be provided without at the same time making it open-ended. The Commission set aside three weeks for the public part of the study and designated this part of the study as a "Meeting". It was so designated because it was not an adversarial proceeding, but simply an opportunity for interested parties to make their views known to the Commission.

1.25 **The Response to the Call For the Study.** The securities industry gave its full commitment to the study. Indeed, in discussions with industry representatives, the Commission learned that the industry was asking itself many of the questions that the Commission was asking. The industry responded very positively to the Commission's

invitation to participate in the study and constituted the Joint Securities Industry Committee ("JSIC") which filed its report entitled "Regulation and Ownership of Market Intermediaries in Canada", September 19, 1984 and a Supplementary Report dated November 2, 1984 (collectively the "JSIC Report").

1.26 Briefs. The Commission received some 43 briefs from representatives of virtually all groups active or interested in the capital markets in Canada, including briefs from a number of multinational securities firms. A list of those who filed written submissions is included in Appendix 6. These briefs proposed a number of alternative models to the JSIC model and provided the Commission with a broad spectrum of alternatives from which to construct its own model.

1.27 The Meeting. The three week period set aside for the public portion of the study was allocated among the interested parties. The actual schedule for the Meeting is set out in Appendix 7. In the course of the Meeting, questioning of the parties was limited to members of the Commission and Commission counsel. The Meeting was completed within the time allocated. Transcripts of the proceedings were prepared.

1.28 The Ontario Task Force Studying Financial Institutions. The Minister responsible to the Legislature for the Commission, the Minister of Consumer and Commercial Relations, constituted in June 1984 a Task Force on Financial Institutions under the chairmanship of Professor Stefan Dupre. We understand that the Task Force is studying the broader question of the organization of the financial system. As noted above, we have accepted, for purposes of our Report, the principle underlying the present organization of the financial system of separate functions performed by different types of institutions. Any relaxation of the segregated nature of our financial system might require a re-examination of certain of our recommendations.

1.29 Non-resident Ownership Recommendations. Also, as noted earlier, in framing our recommendations we have accepted the principle that the capital markets should remain substantially Canadian. Obviously, any change in this principle would require a re-examination of our recommendations. However, unlike the question of the organization of the Canadian financial system in general, the question of non-resident involvement in the capital markets is not to our knowledge currently the subject of any other study and it is unlikely that our recommendations concerning non-resident involvement will conflict with any other policy recommendations currently being made to the Government of Ontario.

1.30 Recommendations Require Action by the Lieutenant Governor in Council. The framework we are recommending to regulate ownership of securities firms would require, in the short term, amendments to the Regulations under the Act. In the longer term, certain of these amendments should be reflected in the Act. The amendments to the Act could be included in the general amending bill which is currently in preparation by the Commission. For now, amendments to the Regulations will require action by the Lieutenant Governor in Council. This Report is therefore made to the Minister for consideration by the Government. It should be noted that it might theoretically be possible to implement some of our recommendations by blanket rulings of the Commission granting exemptions or limiting exemptions from the registration requirements of the Act. We prefer to avoid this approach, believing that ownership of securities firms - an issue already addressed in part in the Regulations to the Act - should be specifically addressed by the Government and implemented in the Regulations. However, if required to do so in the interim, the Commission will deal with any applications it receives which are affected by the matters dealt with in this Report in a manner consistent with its authority under the Act.

1.31 Other Provinces. A word about the involvement of the other provinces in the process is appropriate. In order to reflect the spirit of the general understanding which exists among the securities administrators in Canada that a co-ordinated approach should be attempted before any Commission implements a policy which could have extra-provincial implications, the Ontario Commission invited other administrators to participate in the study to the extent that such participation was feasible. As a result of the invitation, the Chairmen of the Alberta, Manitoba and Saskatchewan Commissions, and other members of the Alberta Commission participated in portions of the Meeting. We understand that the Commissions in these and some of the other provinces may be submitting their own reports to their respective Governments.

1.32 Jurisdictional Limitations of the Recommendations. The recommendations in this Report apply to securities transactions effected in Ontario and securities firms operating in Ontario. References in this Report to capital markets or domestic capital markets refer to the Canadian capital markets based in Ontario. The Commission will continue to consult with the administrators in the other jurisdictions in order to minimize, to the extent reasonably possible, the impact upon the Canadian capital markets of differences between the regulatory model adopted in response to this Report and the regulatory frameworks in the other provinces. In a similar vein, the only SROs over which the Commission has jurisdiction are the TSE and the Ontario District of the IDA. Accordingly, any references to changes in SRO by-laws as a result of the adoption of the Commission model are to the by-laws of these two SROs.

1.33 The model proposed in this Report for regulating the ownership of securities dealers is based upon the many submissions made to the Commission by representatives from virtually all sectors of the capital markets. Chapter II comments more extensively upon the mandate and the philosophy of the Commission in responding to the questions which are the subject of this study.

THE COMMISSION'S APPROACH TO EXAMINING ENTRY AND OWNERSHIP RESTRICTIONS

PART II

2.01 **The Commission's Limited Role in the "Four Pillars" Debate.** The Commission has involved itself in a limited way in the so-called "four pillars" debate on the powers which should be granted to each group of institutions within the financial system. Its involvement is limited because the Commission has not concerned itself with the broad question of the organization of the financial system, but has concerned itself with the narrow question of the extent of involvement of other financial institutions in the capital markets. The Commission's participation in this debate has been in pursuit of a definition of the public interest as it exercises its discretion to determine who can participate in the capital markets and on what terms. The Commission discharges this responsibility by expanding or contracting in appropriate circumstances the registration requirements and the conditions of registration in the Act.

2.02 **The Administration of the Act.** The Act does not contain any express provision describing the Commission's mandate. It simply says that the Commission is responsible for the administration of the Act. One has to determine the Commission's mandate by drawing inferences from the powers conferred upon the Commission by the Act. The principal power of the Commission in administering the Act is the exercise of discretion in the public interest in a number of specified circumstances. For example, under section 73 of the Act the Commission can grant exemptions from the prospectus and registration requirements to allow offerings of securities and other transactions to proceed if the Commission believes that to do so would not be prejudicial to the public interest. In doing so, the Commission can expand the access of specified persons to the capital

markets. On the other hand, the Commission, under sections 123 and 124 of the Act, can cease trading in any securities and can deny to specified persons access to the markets if it believes that to do so would be in the public interest. In exercising its discretion, the Commission must act in the public interest. The question then is, what is in the public interest?

2.03 The Definition of Public Interest. Some have argued that in the exercise of its discretion, the Commission should construe the public interest with reference solely to investor protection concerns. Therefore, it is argued that the only criterion which should be applied by the Commission in determining who should participate in the capital markets is investor protection. Based on this approach, it would be inappropriate for the Commission to contract the registration exemptions in order to extend the ownership restrictions into the exempt market for reasons other than investor protection reasons. However, others would argue that the Commission should take into account concerns about the extent of the involvement of financial institutions and non-residents in the capital markets regardless of investor protection considerations. This difference in approaches requires some elaboration on the Commission's mandate.

2.04 Investor Protection Not the Sole Determinant of the Public Interest. The Commission does not believe that investor protection is its sole criterion in defining what is in the public interest. The Commission believes that its broad responsibility in regulating the capital markets is to create a regulatory environment which encourages the efficient functioning of the markets. The only limitation upon the Commission's discretion in achieving this environment is that the Commission should be mindful and cognizant of expressed Government policy, such as the policy of maintaining a substantially Canadian-owned securities industry. The regulatory environment is achieved through

the administration of the Act, which involves the exercise of discretion in circumstances such as those referred to above, and through the development of amendments to the Regulations and the Act for consideration by the Government and the Legislature.

2.05 Previous Studies Concerning Non-resident Involvement. Historically, there is little doubt that the Commission has involved itself in answering the questions of who should be involved in the capital markets and on what terms. The issues of direct involvement by non-residents in the capital markets and of non-resident investment in resident securities firms were reported on by the Commission to the Government in the 1972 Commission Industry Ownership Report. That Report developed the basis for the current regulatory framework applicable to non-residents which is summarized in Appendix 8. The Commission also reported to the Government in 1979 in the "Suitcase Brokers Report". This Report addressed the activities of non-resident securities firms who, relying upon the exemptions from registration in the Act, are active in the Canadian capital markets.

2.06 Previous Studies Concerning the Involvement of Financial Institutions. The question of investment by financial institutions in securities dealers was studied by this Commission in 1982 and resulted in the Report dated December 14, 1982 to the Minister of Consumer and Commercial Relations Regarding: Institutional Ownership of Securities Dealers Registered Under the Securities Act and Diversification Into Other Businesses by Securities Dealers Registered Under the Securities Act. In that Report, five Commissioners recommended that no investment by financial institutions in securities dealers be allowed and three Commissioners recommended a 10% limit on investment by financial institutions in securities dealers. Neither recommendation was acted on by the Government. The recommendations in this

Report differ from the recommendations in the 1982 Report and reflect conclusions based upon the information gathered in the current study.

2.07 Investor Protection - A Constant in Capital Market Regulation. Having noted the Commission's historic concern about defining the participants in the capital markets, the Commission wishes to emphasize that in achieving the efficient functioning of the market there is one constant, and that is an acceptable level of investor protection. It is obvious that investors make capital markets and if investors do not feel that they will be treated fairly in participating in the capital markets, the efficient functioning of the markets will be in jeopardy. Fair treatment of investors through an acceptable level of investor protection is the principal ingredient in achieving efficient markets. But efficient markets also turn on other factors. Obviously, there must be securities for investors to trade. Therefore, issuers must have confidence that the regulatory environment is balanced between the needs of investors and the needs of issuers to raise capital on reasonable terms. The prompt offering prospectus system is an example of a regulatory initiative where, for certain issuers, the investor protection requirements were considered to be unnecessarily onerous. These requirements were relaxed and yet an acceptable level of investor protection has still been retained.

2.08 Confidence in Market Intermediaries. The efficient functioning of the capital markets also requires that both investors and issuers have confidence in market intermediaries - the brokers and investment dealers who provide the links among investors and who bring the issuers to market. Market intermediaries are subject to a number of regulatory requirements that are motivated by investor protection concerns, such as the requirement that sales persons have completed required courses of study, require-

ments for minimum capital and so on. But we believe that confidence in market intermediaries also turns on such considerations as who owns the market intermediary. To cite an obvious example, ownership of a market intermediary by a financial institution might give rise to actual or perceived conflicts of interest which, unless properly regulated, could reflect negatively upon the industry structure and ultimately detract from the efficient functioning of the market. Who can own a market intermediary or who can set up a securities firm is therefore an important part of the regulatory framework for the capital markets.

2.09 The Commission's Mandate. In summary, the Commission's mandate is (i) to administer the Act and the Regulations, which includes adopting policies to give guidance as to the exercise of its discretion under the Act and Regulations, and (ii) to recommend amendments to the Act and Regulations. The Commission's objective in exercising these powers is to balance the need for investor protection and the needs of issuers and market intermediaries, and thereby create the regulatory environment for an efficiently functioning capital market. The Commission must always recognize in seeking this balance that investor protection is the key ingredient to investor confidence, which in turn is the key ingredient to efficient capital markets. Other measures aimed at achieving efficient capital markets can be implemented only if the regulator is satisfied that an acceptable level of investor protection would prevail.

2.10 Report Within the Commission Mandate. The Commission believes that its mandate requires it to be sensitive to evolving issues affecting the structure of the marketplace and to take action to deal with these issues at the appropriate time. The action of the Commission in submitting this Report will advance the debate on ownership of securities firms, will better equip interested parties

and the Commission to deal with individual cases relating to these issues as they arise and will provide the basis for a new framework regulating entry and ownership in the securities industry.

2.11 Starting Points. Having satisfied ourselves that the study leading to this Report is well within our mandate, we would now like to set out a general approach in dealing with the issues under study. There are two readily apparent starting points in assessing ownership restrictions applicable to securities firms. One is the existing framework which is a combination of the rules of the SROs and the Regulations under the Act. The other is an unregulated environment - a regulatory framework without ownership restrictions.

2.12 The Free Market Approach. We have adopted the unrestricted regulatory environment as our starting point because we believe that as a general matter in our free enterprise system (i) the forces of competition should determine who can act as a market intermediary in the capital markets and (ii) any competitive restrictions imposed upon market intermediaries must be well founded in public policy and must be the minimum necessary to achieve that policy. We refer to this approach as our "free market approach".

2.13 Adequacy of Capital - Is It Really the Issue? There was much debate in the course of the Meeting about the adequacy of capital in the securities industry. Many argued that the industry is inadequately capitalized and that this inadequacy inhibits its ability to serve Canadian issuers and investors and gives rise to the need for a regulatory environment which protects the industry from the competition of better capitalized non-resident dealers and financial institutions. The JSIC stated that the industry is adequately capitalized and that it is well positioned to serve the needs of Canadian issuers and investors.

2.14 The Regulatory Concern is Access to Capital. We believe that, as part of our free market approach and subject to the overriding policy concerns of a substantially resident owned securities industry and respect for separate functions in the financial system, the policy basis for our model should not be adequacy of capital, but rather access to capital. We did not arrive at our conclusion by developing a model which will generate adequate capital for the industry. This approach would be similar to setting a stock exchange commission rate schedule, a task which the Commission has determined would be better achieved by free market forces. Instead, in designing ownership restrictions the Commission has adopted the free market approach of unrestricted access to capital, limited only to the extent necessary to implement overriding public policy considerations. Within this framework each individual securities firm should be able to raise its optimum amount of capital. What we have tried to do is allow private initiative and innovation within a regulatory environment which respects both the overriding public policy objectives referred to above and our free market approach.

2.15 Our Model. The model that we recommend be implemented immediately by the Government of Ontario is described in Part III of this Report. As is apparent from our recommendations we believe that the existing restrictions are unnecessarily restrictive and we recommend a relaxation of these restrictions, except as they apply to certain activities in the exempt market.

THE COMMISSION'S RECOMMENDED MODEL
PART III

3.01 Implementation Forthwith. We recommend that the Regulations under the Act be amended forthwith to implement the following regulatory framework and that the by-laws of the TSE and the IDA applicable to registrants under the Act be amended so as not to be inconsistent with this regulatory framework. The following rules would apply if the Commission model were adopted:

NON-RESIDENT INVOLVEMENT IN THE CAPITAL MARKETS

3.02 Investment in Registrants.

(i) Non-residents, including any single non-resident, would be permitted to own securities of a dealer registrant carrying up to (a) 30% of the votes or (b) 30% of the equity participation or (c) a combination of (a) and (b) amounting to 30%. (The securities in the previous sentence are sometimes referred to as participating securities.) (Ownership restrictions applicable to advisers are discussed in paragraph 3.23. Registrants other than advisers are called "dealer registrants".)

(ii) The participating securities could be outstanding or newly issued.

(iii) If non-residents in the aggregate own more than 10% of any class of participating securities, then a single industry investor (or a group of industry investors committed, through a holding company, voting trust or other arrangement, to exercising their voting rights as a single investor) must own securities carrying more than 50% of the votes and more than 50% of the equity participation. For example, the industry investor could be a holding company

owned entirely by the employees of the securities firm. The shareholdings of the holding company must not be structured to frustrate the requirement that, directly or indirectly, over 50% of the participating securities of the firm must be owned by industry investors. The industry investor required by this section is sometimes referred to as the "significant industry investor". The definition of "industry investor" in the JSIC Report, which is attached as Appendix 9, will be used as a guideline in drafting the Regulations to implement these recommendations.

(iv) Commission approval of any single non-resident owning more than 10% of the participating securities of a dealer registrant will be required; the arrangements to ensure that the dealer registrant has a sigificant industry investor will also be subject to Commission approval.

(v) A non-resident can either invest in a registrant or can enter directly as a foreign dealer registrant under that category described in paragraph 3.03 but not both unless the registrant is a firm with publicly traded securities, in which case the non-resident can also own less than 10% of the securities which are publicly traded.

(vi) The securities of the dealer registrant, other than those held by non-residents and the significant industry investor, can be held by anyone else, subject to the 30% limitation applicable to non-residents and the 30% limitation applicable to financial institutions and the 30% limit applicable to a single other resident investor referred to in paragraphs 3.10 and 3.12. Shares held by a financial institution which is also a non-resident would be characterized, for purposes of the Commission's model, as shares held by both a non-resident and a financial institution.

3.03 Direct Entry By Foreign Dealer Registrants. A new class of dealer registration should be created for

securities firms in which non-residents own more than 30% of the participating securities. This category of registration of non-resident securities firms should be granted this class of registration. The grandfathered non-resident firms should be included in this new class of registration. A registrant in this category will have to be a Canadian subsidiary of the non-resident securities firm. A limit should be imposed upon the aggregate capital employed by this class of registrant. The limit on the amount of capital would be approximately 30% of all of the capital employed in the industry. On the assumption that the capital of the resident firms is approximately $700 million and that the foreign dealers utilize the maximum capital that would be permitted to them, the total capital in the industry would be one billion dollars, of which $300 million would be available to the foreign dealers. No single foreign dealer registrant should be allowed to have an amount of capital in excess of 1.5% of the capital of the industry. (This firm limit would not apply to the non-resident grandfathered firms: see paragraph 3.08 below.) The individual firm ceiling would then be approximately $15 million. The ceiling would apply to the aggregate of accumulated earnings and invested capital. The Commission should have the discretion to revise periodically the limit on the aggregate capital available to this class of registrant and the individual firm limit. The only permissible shareholders of foreign dealer registrants, in addition to the non-resident parent, would be the employees and other investors approved by the Commission.

3.04 Commission Grants Foreign Dealer Registrations. The firms which would be granted this registration would be determined by the Commission on application by interested firms. All applications would have to be submitted in a one-time tender process on a date to be specified by the Commission. The Commission would grant applications and set capital limits on an informal basis after assessing the services that the applicant would bring to the Canadian marketplace and the need for those services. The Commission

would also allocate the registrations in a manner which assures some diversity in the country of origin. The criteria which the Commissionwould apply in granting the foreign dealer registrations would be published by the Commission at the time of its invitation for applications. Apart from the overall and individual firm limits on capital, there would be no preset limit on the number of registrations to be granted in this category, although the Commission would have to take into account, in deciding upon the number of registrations to be granted, the impact of the new registrants on the marketplace. The Commission's decision in the granting of these registrations would not be carried out in a public hearing. The process would be informal and in consultation with the Director.

3.05 Foreign Dealer Registrants Must Be Securities Firms. The category of foreign dealer registration would only be available to Canadian subsidiaries of foreign firms which carry on a securities business. It could not be used by a foreign financial institution or other foreign corporation to diversify into the securities business in Canada when it is not in the securities business in its home jurisdiction. The foreign parent may carry on other businesses but this will not preclude the granting of a registration subject to the limitation on foreign parents which are financial institutions operating as such in Canada, referred to in paragraph 3.09.

3.06 Annual Review. The foreign dealer registrants would be obligated to report annually to the Director to enable the Director to monitor their impact and to assess whether the commitments of the registrant are being satisfied. On that basis, and depending upon the state of the industry, the Commission would have the discretion to vary the capital limit on an individual firm within the 1.5% of industry capital restriction. So, for example, if a foreign dealer was allocated $15 million at the time of its application and

two years later the industry capital is $1.2 billion, the Commission could increase the dealer's limit to $18 million.

3.07 Review in Two Years. The impact of these registrants on the marketplace should be studied by the Commission in approximately two years after the granting of the registrations and the Commission should then have the power to adjust the number of foreign dealer registrants, invite new applications and recommend such other changes to the Regulations as may then be appropriate.

3.08 Repeal of Code for Regulating Grandfathered Firms. The entire code in the Regulations applicable to the grandfathered firms should be repealed and the three grandfathered firms should be governed by the rules applicable to the foreign dealer registrants, except that the grandfathered firms would not be subject to the 1.5% of industry capital limit applicable to individual foreign dealers. Each grandfathered firm would have its own limit established by the Commission and the aggregate capital of the grandfathered firms would be included in the 30% of industry capital limit applicable to all foreign dealers.

3.09 Restriction on Foreign Dealer Ownership. A non-resident securities firm, owned more than 30% by a financial institution which carries on business as such in Canada, would not qualify for a foreign dealer registration. Prudential-Bache Securities Limited would be grandfathered under this latter requirement although this grandfathered status might have to be reconsidered in the event that the Government's policy on the segregation of the sectors of the financial system is changed in the future. [7] A change of ownership of a foreign dealer registrant which

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[7] Because of a previous professional association with Prudential-Bache Securities Limited, the Chairman of the Commission did not participate in the discussion concerning the application of the proposed rules to Prudential-Bache.

contravenes this ownership limitation would require the registrant to forfeit its registration within a reasonable period of time. As noted in paragraph 3.02(v), a non-resident which has obtained a foreign dealer registration cannot be an investor in another registrant unless the other registrant is a public offering registrant in which case the non-resident can own up to 10% of the publicly offered securities.

OWNERSHIP OF SECURITIES FIRMS BY FINANCIAL INSTITUTIONS AND OTHER INVESTORS

3.10 **Same Restrictions for Financial Institutions as for Non-Residents.** The rules applicable to investment by financial institutions in securities firms parallel the rules applicable to investment by non-residents in securities firms. Financial institutions, including a single financial institution, could own up to 30% of the participating securities of a dealer registrant, provided that if financial institutions in the aggregate own more than 10% of the participating securities of the dealer registrant the dealer must have a significant industry investor. The securities, other than those held by financial institutions and the significant industry investor, could be held by anyone else subject to the 30% limitation applicable to non-residents and financial institutions and the 30% limit applicable to a single other resident investor and subject to the requirement for Commission approval of any non-industry investor holding more than 10% of the participating securities of a dealer registrant. See paragraph 3.02(vi) concerning financial institutions which are also non-resident.

3.11 **No Direct Entry For Financial Institutions.** There would be no direct entry provisions available for financial institutions subject to paragraphs 3.20 and 3.23.

3.12 Investment by Other Resident Investors. The final category is that of the investor who is neither a financial institution nor a non-resident - called the other resident investor. The model would treat this class of investor in a manner similar to the treatment of the financial institution investor except that a 49%[8] ceiling would apply to holdings of other resident investors in the aggregate. Any one other resident investor could hold 30% of the participating securities and other resident investors could hold the difference between the significant industry investor and the other resident investor holding the 30%.

3.13 Grandfathering of Holdings of Other Resident Investors. Existing shareholdings of dealer registrants not consistent with this requirement would be grandfathered as of the date of this Report. Any change would be subject to review by the Commission.

3.14 Industry Investors Must Own 51% of a Dealer Registrant. Under all circumstances industry investors must own at least 51% of the participating securities of a dealer registrant. This 51% must be combined into a significant industry investor whenever non-residents, financial institutions or other resident investors own more than 10% of the participating securities in the aggregate.

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[8] In this Report the abbreviation "49%" refers to 50% less one share and the abbreviation "51%" refers to 50% plus one share.

CANADIANS DEALING IN INTERNATIONAL MARKETS

3.15 Registration Exemption for International Transactions. Appropriate exemptions from the registration requirements of the Act would be continued to allow non-resident securities firms to facilitate financing by Canadian issuers outside Canada [9] and to allow non-resident securities firms to accommodate the needs of Canadian investors wishing to trade securities outside Canada. The model proposed by the JSIC in Part II of Appendix IV of the JSIC Report would, subject to the comments below, be used as a general guideline. The Commission model would allow the following activities:

(i) Facilitating Distributions Outside Ontario. Non-resident firms unregistered in Ontario could carry on in Ontario those activities reasonably necessary to facilitate a distribution of securities by a Canadian issuer outside Canada, provided that the securities so issued "come to rest" outside Canada. The Interpretation Note of the Commission entitled "Distributions of Securities Outside Ontario" addresses the question of securities coming to rest in jurisdictions outside Ontario. The "coming to rest requirement" is subject to the provisions in paragraph (iii) below that a portion of an offshore offering may be placed back in Canada with designated purchasers as defined in that paragraph.

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[9] To be precise we should be referring to Ontario which is the limit of our jurisdiction. However, because the transactions with which we are primarily concerned occur outside Canada, we are referring to international transactions as those outside Canada rather than outside Ontario (although the framework is equally applicable to transactions outside Ontario but within Canada).

(ii) Unsolicited Trades Executed Outside Canada. Any unregistered firm, whether resident or non-resident controlled, could accept an order originating in Ontario to trade securities in a market outside Canada provided no solicitation of trades occurs in Ontario. This provision recognizes that many Ontario residents - both institutional and retail - have accounts with offshore firms which the residents operate by telephone.

(iii) Trades in the Course of Distribution Outside Ontario. Non-resident firms which are not registered may solicit designated purchasers (defined below) with respect to sales of securities being primarily distributed to investors outside Canada. The Commission will issue guidelines on when an issue is being distributed primarily to investors outside Canada. A designated purchaser would be any financial institution to which securities could be sold without registration pursuant to the exemptions in the Act and any investor who would qualify under the private placement exemption in the Act.

(iv) Foreign and Interlisted Securities. Designated purchasers may also be solicited with respect to secondary transactions in interlisted securities and foreign securities - "foreign securities" being defined to include (a) any security of a non-Canadian issuer, (b) equity securities of Canadian issuers that are distributed outside Canada and for which no active trading market exists within Canada and (c) debt securities of Canadian issuers that are distributed outside Canada.

(v) Registration to Solicit Retail Accounts for the International Market. A simple form of registration would be available to any non-resident firm wishing to solicit investors other than designated purchasers to trade in foreign securities. This category of registration would be the international dealer registration. This registration

would not have attached to it the ownership or capital limitations recommended in this Report and would not require the dealer to have an office in Ontario. It would be designed to ensure that investors, other than designated purchasers wishing to trade foreign securities, would have the benefit of the "know your client", "suitability for investment" and other rules imposed by the Commission on registrants. The registration would only permit activities in securities traded in offshore markets. This registration would not be available to an offshore securities firm controlled by residents of Canada which could not comply with the ownership requirements applicable to dealer registrants in the Commission model.

(vi) Office Requires Registration. No firm restricting its activities to the international market and to activities that would be exempt from registration could open an office in Ontario without having a registration as a foreign dealer or an international dealer.

THE EXEMPT MARKET

3.16 International Exempt Market. As noted in paragraph 3.15 exemptions from the registration requirements to facilitate trading by Canadians in the international markets would continue with the revisions suggested in that paragraph.

3.17 Exempt Market for Government Securities Continues. The registration exemptions for securities in paragraphs 1, 2 and 4 of subsection 34(2) of the Act, i.e. the exemptions for government debt securities, trust company guaranteed investment certificates, and commercial paper would also continue.

3.18 Exemptions for Private Underwriting Removed. The registration exemptions for trades in paragraphs 3, 4 and 5 of subsection 34(1) of the Act, i.e. the exemptions for specified financial institutions, exempt purchasers, and $97,000 private placements would not be available to non-registrants who rely on these exemptions to carry on, in effect, a private underwriting or full service brokerage business. Put another way, subject to the provision in the preceding paragraph, the Regulations will provide that no person may, as principal, agree to purchase corporate securities with a view to distribution or may, as agent, offer for sale or sell such securities in connection with a distribution without being registered.

3.19 Unregistered Affiliates. With the removal of underwriting and full service brokerage from the exempt market the attraction to dealer registrants of establishing an affiliate whose activities are limited to the exempt market is considerably diminished. If a dealer registrant chooses to establish such an affiliate it will have to seek the Director's approval and in doing so, convince the Director of the benefits to the registrant and the marketplace of having such an affiliate.

EXEMPTIONS FROM OWNERSHIP RESTRICTIONS

3.20 The Commission would retain the power to grant registrations to any person or company which does not comply with the ownership restrictions if the person or company is seeking a registration under the Act in respect of any activity which is not one of the protected functions, i.e. underwriting and full service brokerage, or which does not materially impair the ability of the securities industry to carry on the protected functions. An example of such a registration is the registration of a financial institution providing a discount brokerage access service or the dealer registration of a bank, whether a Schedule A or Schedule B

bank, to act as a member of the selling group in the distribution of securities in a public offering.

NETWORKING

3.21 Securities firms would be permitted to distribute the products of other financial institutions if the arrangement were approved in advance by the Director of the Commission. Approval by the SROs of networking proposals would not be required, although the Director would generally consult with the SROs on each networking proposal. As the Commission acquires experience with networking it will substitute for approval by the Director of networking proposals a set of criteria which may be satisfied independently of any approval required of the Director. These criteria will be designed to ensure that investor protection concerns and the overriding public policy relating to separation of functions in the financial system are not compromised by any networking arrangement.

OTHER

3.22 Publicly Owned Firms. Securities firms which have offered their securities to the public did so relying on the SRO by-laws summarized in paragraph 1.11. These by-laws limit a single investor, other than an industry investor, to owning 10% of the participating securities of a securities firm which is an SRO member. We believe that (i) no single investor (other than an industry investor) owns more than 10% of the participating securities of such firms, (ii) such firms have offered more than 10% but less than 50% of their participating securities to the public; and (iii) the balance of the participating securities are owned by industry investors. It should therefore be possible for such firms to comply with the Commission model which would require each firm to have a significant industry investor and to impose a limit on the maximum holdings of any single

outside investor of 30% and impose a limit of 49% on the maximum holdings of outside investors generally. If we have misjudged the circumstances of any firm which has gone public, the firm may seek relief from any of the foregoing requirements from the Commission.[10] Firms which propose to offer their securities to the public will be required to conform to the ownership requirements recommended in this Report. The constrained share provisions in their charters will be required to contain a provision which ensures that no one non-industry investor can acquire more than 30% of the participating securities of the dealer. The SRO by-laws relating to publicly owned firms should be amended to impose the 49% limit on aggregate holdings by other resident investors, the 30% limit on the holdings of any single other resident investor and the requirement for the significant industry investor.

3.23 No Restrictions on Ownership of Advisers. The adviser category of registration will not be subject to any ownership restrictions.

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[10] Commissioner Blain would not impose the significant industry investor requirement on the registrants which have gone public but would impose this requirement on any of such registrants at any time the registrant offers further shares to the public.

COMMENTARY ON THE MODEL
PART IV

4.01 Objectives of the Commission. The Commission's model in general terms is intended to achieve the following objectives:

(i) The Commission's model implements the over-riding public policy objectives in a manner which is less restrictive and more responsive to existing needs than the existing ownership structure. Indeed the model extends these policies to a vital area of the capital markets - the underwriting and full service brokerage components of the domestic exempt market.

(ii) By extending the registration requirements to underwriting and full service brokerage in the domestic exempt market, a potentially important part of the domestic capital markets becomes subject to regulation. The principle of the protected functions advanced in the Discount Access Report is thereby extended to the exempt market.

(iii) The Commission believes that more efficient domestic markets and a more competitive industry, both domestically and internationally, will develop from the Commission model.

(iv) Improved access to capital will be possible and individual firms will be able to achieve their optimum level of capital within a more relaxed ownership environment.

4.02 Comments on the Model. We would now like to comment on the specific components of the Commission's model.

REDUCING THE RESTRICTIONS ON NON-RESIDENT PARTICIPATION IN THE CAPITAL MARKETS

4.03 Direct Investment in Resident Dealers. Investment by non-residents in registrants is now limited to 10% by any single non-resident and 25% by non-residents as a group. These limits were supported by the JSIC in its submission to the Commission. The ownership limits have denied a potentially important source of capital to Ontario registrants. We believe that these limits do not have to be as strict to achieve the objectives of having a substantially Canadian securities industry and of protecting the domestic securities industry from domination by non-residents. The rules have operated, not to protect the domestic industry from domination by non-residents, but to reduce the non-resident component in the industry gradually.

4.04 30% is Cautious. Under the 10/25 formula referred to in the previous paragraph, the JSIC would have allowed non-residents to own up to 25% of resident securities firms. The Commission model would allow non-residents to own up to 30% of resident securities firms. The Commission's position is not materially different from the industry position as to what constitutes a substantially Canadian industry. Where the Commission did part ways with the industry is in allowing one non-resident to own 30% of a Canadian firm. But the Commission model adds the requirement for the significant industry investor. The 30% level is below that level which permits the holder to achieve negative control of the firm but we hope is high enough to enable Canadian firms to attract desired investments and the genuine interest of, but not dominance by, a non-resident firm.

4.05 The Significant Industry Investor. We have coupled the more relaxed ownership limits with the requirement that if there is a significant non-resident shareholding, that is between 10% and 30%, the registrant must have an even more significant industry shareholder. The model is drafted so that the 30% ceiling test applies to both votes and equity.

4.06 Canadian Firms Substantially Owned By Industry Investors. The requirement for the significant industry investor should not be a problem for most dealer registrants because virtually all registrants (other than the non-resident grandfathered firms) are at least 51% owned by industry investors. The requirement that any non-resident holding in excess of 10% of the participating securities of a dealer registrant must be approved by the Director also permits the Director to review the arrangements putting the significant industry investor in place to ensure that it is consistent with the objectives in this Report.

4.07 Attracting "Synergistic" Capital. The 30% ceiling may provide an avenue to those firms wishing to attract a substantial investment from a multinational securities firm. In this respect, we are hopeful that the 30% level

because it was concerned more with providing firms with access to capital than with the adequacy of capital it was not important whether purchases by non-residents added capital to firms or simply substituted for existing capital. The Commission also had a secondary concern that if it did require new purchases by non-residents to be made from treasury, it would be difficult to ensure that the new capital remained in the firm.

4.09 Approval of Shareholders. Under the Act, a registrant is required to inform the Director of any new holder of voting securities unless an exemption has been granted (such as for publicly owned registrants). This notification allows the Director an opportunity to approve new investors. Accordingly, the Director will have the opportunity to approve any new non-resident shareholder holding more than 10% of the participating securities of the dealer registrant.

DIRECT ENTRY BY NON-RESIDENT SECURITIES FIRMS

4.10 Under the existing ownership restrictions it is not possible for a non-resident firm to carry on business in Ontario unless its business is confined to activities allowed under the exemptions from registration. There are three non-resident dealers which are grandfathered under the restrictions against non-resident ownership - two of which are full service securities firms . There have been no new entrants from outside Canada into the business in Ontario since the early 70's. The proportion of the industry capital which is represented by non-residents has declined since the enactment of the ownership restrictions in 1971. There is no present threat of domination of the domestic industry by non-residents.

4.11 Current Non-resident Restrictions Outmoded. We think these restrictions are unnecessarily restrictive in maintaining a substantially Canadian investment industry and unrealistic in controlling access of Canadian issuers and investors to offshore capital markets. Much of the activity of Canadian issuers and investors in the offshore markets occurs in the exempt market which by definition is not available to retail investors and within limits that are not always clearly defined. We think the emphasis of regulation should be to recognize this activity and define the terms and conditions under which it can take place. Therefore, allowing a limited number of non-resident firms to carry on business in the Canadian marketplace will, in addition to providing competition to the domestic firms in Canada, improve the access of Canadian issuers and investors to offshore markets.

4.12 Model is the Cautious Approach. We think it might be possible for all restrictions on new entrants to be dropped without impairing the ability of the domestic industry to thrive and remain substantially Canadian. However, we have chosen to proceed incrementally and cautiously in relaxing the restrictions on direct entrants. While the 30% investment provision addresses the needs of existing firms to have access to fresh capital and fresh ideas, the direct entry provisions address the needs of the marketplace to be more open to the capital markets outside Canada and to be exposed to more diverse investment opportunities which will come as a result of the commitment of new capital and new expertise to the marketplace. In deciding how to proceed, we have adopted an approach comparable to that used in the Bank Act which allows a limited number of foreign-owned banks to carry on business in Canada, each with a limit upon capital. The conditions of registration will require applicants for the foreign dealer registration to incorporate Canadian subsidiaries in order to regulate the limits on capital.

4.13 Controlling New Non-resident Entrants. The index we have chosen for measuring non-resident involvement is capital. The efficacy of this index to achieve this objective can be debated, but we have chosen it over other indices such as revenue or assets or number of employees, because it generally is the best measure of the amount of business a registrant is doing. It is also an index used elsewhere in the Act. For example it is the index used to control the amount of business now done by the grandfathered non-resident firms.

4.14 Capital as the Index. However, we have some reservations about using this index because, as regulators, we generally encourage capital to be invested in a registrant as a means of achieving investor protection whereas in this model we would impose a ceiling on the capital of foreign dealers. On balance, we have decided that whatever is lost by limiting the amount of the capital invested is offset by allowing new entrants into the capital markets on a controlled basis, thereby making possible the introduction of new services and expertise to the Canadian investment community.

4.15 Aggregate and Individual Capital Limits. We are imposing both a limit on the aggregate capital of non-resident firms and an individual firm limit on capital. The aggregate limit is approximately 30% of what would be total industry capital (which includes the capital of the foreign dealers). The limit per firm will not be more than 1.5% of total industry capital. This limit will generate a figure which is well below the capital of the money market dealers and ensures that no foreign dealer can assume a dominant position in the domestic industry and that the foreign dealers as a group cannot achieve a dominant position.

4.16 Applications For Foreign Dealer Registration. We find it difficult to judge how many applications will be made for this new class of registration. We doubt that there will be numerous applications but if there are, the Commission will have to draw a line and limit the number of new entrants to ensure that the impact is acceptable. The Commission will specify certain considerations which it will take into account in deciding which applications to accept and the capital which should be allocated, including:

(i) What sectors of the market will the applicant serve? Will the applicant facilitate the access of the retail sector to services related to the international markets? What services will be introduced into the marketplace? (For example, the suggestion was made in the course of the Meeting that many small and medium sized businesses were not well served. An applicant proposing to serve this sector of the business community might be viewed favourably.)

(ii) What steps will the dealer take to neutralize any advantages it might have in underwriting securities of a Canadian company which is affiliated with a non-resident company for which the dealer's parent acts as underwriter?

(iii) What presence has the applicant had in the Ontario marketplace historically?

Similar to decisions under section 73 of the Act, a decision by the Commission concerning the granting of a registration to a foreign dealer should be final and there should be no appeal from it.

4.17 Paying Out Excess Capital. In allocating capital, the Commission will review the requests and allocate amounts reasonably necessary to enable a foreign dealer to achieve its business objectives. Not all of the allocated amount will have to be invested immediately. Earnings of the foreign dealer not paid out will be included in its capital, but once the accumulated earnings exceed the allocated amount, the foreign dealer will be obligated to pay out the excess.

4.18 Annual Review. The Commission will review annually the status of the business of the foreign dealers and may reduce or increase allocated capital based on its assessment of the firm's performance, measured against its objectives.

4.19 Foreign Dealers' International Business. As noted above, we also anticipate that most of the non-resident firms which seek this new category of registration will do so to enable them to carry on, on a more efficient basis, their international business involving Canadian issuers and investors, even though most of that business will be exempt from the registration requirements altogether. To the extent that the foreign dealers are interested in domestic business, they will provide what we believe will be a specialized expertise in certain areas and a positive competitive influence for resident securities firms.

4.20 Limit on Ownership of Foreign Dealers by Financial Institutions. In order not to give a non-resident financial institution an unfair advantage over a resident financial institution, an applicant for a foreign dealer registration owned more than 30% by a financial institution which carries on business as such in Canada, either directly or through a subsidiary, would not qualify for this class of registration. For example, a non-resident bank which owns a Schedule "B" bank under the Bank Act, could not obtain a foreign dealer registration for itself or another subsidiary

because this registration would not be available to a resident financial institution. To do otherwise would compromise the four pillar policy. The parent of an applicant for a foreign dealer registration must carry on a securities business in its home jurisdiction. It may be argued that a non-resident securities firm will have an advantage over domestic firms in that it could be in a business or be affiliated with firms carrying on business in the foreign jurisdiction that would not be possible in Canada. The Commission will have to scrutinize each application to ensure that the applicant is essentially a securities firm and that any affiliations it has in its home jurisdiction will not be used in Canada to compromise the separation implicit in the Commission model, not only between securities firms and financial institutions, but also between securities firms and other commercial corporations.

4.21 The Grandfathered Firms. There are three grandfathered dealers. They are subject to a code which assigns to each of them a permissible capital which floats in relation to an index, domestic base capital, which is the average of the capital of the money market dealers. If the grandfathered firm's actual capital is in excess of its permissible capital, it is obligated to reduce its capital to the permissible level. If the actual capital of the grandfathered firm is less than its permissible capital the only source of capital available to the grandfathered firm is earnings. The operation of these provisions is complex and in some respects outmoded. For example, whenever the parent of a grandfathered firm pays a dividend, the grandfathered firm is obligated to pay a dividend in the same proportion to its retained earnings as any dividend paid by the parent company is in proportion to the parent's retained earnings. This provision was implemented at a time when Canadian dealers could not go public and the theory was that the grandfathered firm through its parent had access to a source of capital, i.e. the public markets, that was not

available to resident firms and therefore enjoyed a competitive advantage. If the cost of enjoying this competitive advantage was the payment of dividends to public shareholders then this was a cost that had to be incurred by the grandfathered firm as well. Since the enactment of this requirement Canadian firms have been allowed to raise capital from the public and therefore the rationale for the requirement no longer exists. There are other problems with the code applicable to grandfathered firms such as the timing of the determination of a firm's permissible capital.

4.22 Repeal of Code Applicable to Grandfathered Firms. The Commission has decided that an integral part of its model is the repeal in its entirety of this complex and outmoded code and its substitution with the Commission's discretion which is applicable to the new category of foreign dealer registrant. The registration of the grandfathered firms will continue in the foreign dealer category, but it will be up to the Commission in the course of its general assessment of the extent of non-resident involvement in the Canadian capital markets to impose capital limits upon the grandfathered firms based upon their contribution to the capital markets in Canada.

4.23 Change of Ownership of Foreign Dealer. All material changes of ownership of foreign dealer registrants would be reviewable by the Commission. A change of ownership that would result in the foreign dealer being more than 30% owned by a financial institution carrying on business in Canada, directly or through a subsidiary, would not be permitted. The registrant would have to give up its registration or adjust its ownership within a reasonable period of time.

NATIONAL CONTINGENCY FUND

4.24 Contingency Funds. Foreign dealer registrants will be obligated to participate in the National Contingency Fund if they become members of any of the SROs or will be obligated to participate in the trust fund maintained by the Commission for dealer registrants which are not members of the SROs. The terms of the National Contingency Fund are being studied by the Canadian Securities Administrators independently of this study and the Commission is also reviewing the terms of the trust fund maintained for non-SRO members.

INVESTMENT IN SECURITIES FIRMS BY FINANCIAL INSTITUTIONS

4.25 30% Limit Applicable to Financial Institutions. As noted earlier, the Act is silent on investment by financial institutions in dealer registrants. The SRO by-laws limit the holding of any single financial institution to 10%, but do not impose any limitation on the aggregate. The Commission believes that the four pillar principle can be maintained with a 30% limit on investment by financial institutions in dealer registrants.

4.26 30% Balances Need for Capital and Need for Separation. There is logic in extending the 30% limit imposed on non-resident investment in dealer registrants to financial institution investment in dealer registrants. In both circumstances, we are balancing, on the one hand, our concern for the overriding public policy objective (in this case the organization of the financial system into separate components) and on the other hand our belief in providing maximum access to sources of capital. We believe that the 30% limitation coupled with the requirement for a dominant industry investor represents the optimum balance between the competing concerns. This approach will allow the dealer

registrant access to an additional source of capital and whatever beneficial influence the financial institution may bring and yet to protect itself from control by the institution. The maintenance of the separate functions by the different groups of participants in the financial system is based upon a number of concerns, including concentration of financial power and conflicts of interest.

4.27 Conflicts of Interest. The protection against control is important because of the concerns about actual and perceived conflicts of interest between the financial institutions and dealers. The conflict of interest concern was not one that had to be addressed in the context of non-residents investing in dealer registrants. The main concern was one of foreign domination of the industry.

4.28 Concentration of Power a Greater Concern. We are, however, more impressed by concerns of concentration of power than concerns about conflicts of interest. The securities industry has experience in dealing with conflicts of interest and we expect that methods could be devised for dealing with conflicts of interest between a financial institution shareholder and a securities dealer. Such methods might range from rules against self dealing to disclosure requirements. Concentration of power, on the other hand, could reduce, or be perceived to reduce, the number of real independent financing options available to an issuer and the number of independent dealers in the market with whom investors would be willing to deal.

4.29 Recommendations Concerning Non-residents More Urgent. Although this Report addresses the question of outside involvement generally in the capital markets, we attach greater urgency to our recommendations concerning involvement by non-residents than to our recommendations concerning financial institutions and other resident

investors. Easing the restrictions on non-resident involvement is designed to provide access to an important source of capital and expertise, and one of the side benefits will be to improve access of Canadian issuers and investors to the international markets. Improvement in this access is going to occur in any event. We should have a regulatory framework which recognizes this development but which regulates internationalization of our markets in order to enforce overriding principles of public policy. The involvement of financial institutions and other commercial enterprises not affiliated with financial institutions in our capital markets requires the same recognition and control but we attach less urgency to this area. There has been no securities firm appearing before us and arguing in favour of the synergy which might result from a trust company or an insurance company or a bank investing in the firm. On the other hand, a number of securities firms have argued strenuously that investment by non-resident firms in resident securities firms be permitted.

THE POSITION OF OTHER RESIDENT INVESTORS IN SECURITIES FIRMS

4.30 Separation of the Commercial and Intermediation Components of the Financial System. "Other resident investors" refers to investors other than industry investors, financial institutions, and non-resident investors, i.e. commercial enterprises and individuals. We debated extending the 30% limitation to these other resident investors because the public policy and regulatory concerns applicable in the case of non-residents and financial institutions are not as apparent in the case of these other resident investors. We concluded that the ownership limitation should be extended to this area in order to reduce the potential for major industrial groups in the economy who are frequent users of the capital markets to establish "tied houses". We believe it is important to the efficient functioning of the market that there should be a sufficient number of dealers to create a competitive

environment and that the dealers should be independent not only of financial institutions, but also of other commercial enterprises. We again believe that the 30% limitation opens up a source of capital to dealers without allowing a commercial enterprise to dominate an investment dealer. We also believe that the traditional separation between the commercial component of our financial system and the securities industry component of our financial system has contributed significantly to the independence of the securities industry which in turn has contributed significantly to the efficiency of our capital markets. It is a separation which we believe should be preserved. Our approach concerning investment by commercial enterprises in dealer registrants is consistent with the cautious and incremental approach that we have taken in this matter.

BY-LAWS OF THE SELF-REGULATORY ORGANIZATIONS

4.31 The provisions of the by-laws of the SROs relating to admission and ownership should be amended to conform with the Commission's model. This means that the by-laws should not only relax the requirements for non-resident, financial institution and other resident investor ownership of SRO members, but should be revised to permit the admission of any registered foreign dealer to membership.

ACCESS TO INTERNATIONAL MARKETS

4.32 Access of Issuers. Allowing non-resident dealers to carry on, without registration, the activities which are necessary to enable Canadian issuers to finance in the offshore markets is not disputed. It is a fact of life that major Canadian issuers, before they finance in any market, assess the cost of financing in the principal world markets. The dealers in those markets should be uninhibited in their access to Canadian isuers.

4.33 Access of Investors. By allowing resident issuers to finance in the international markets, the provisions of the Commission's model simply reflect the current practice of allowing non-resident firms easy access to domestic issuers provided the securities offered abroad come to rest abroad, subject to one limited exception. Resident institutional investors generally can be solicited by non-resident securities firms to purchase securities being distributed offshore if the offering is being made primarily offshore and also can be solicited by such firms to purchase foreign and interlisted securities in the secondary market. This also reflects current practice. Retail investors could only be solicited to purchase foreign securities by non-resident firms which obtain a simple form of registration which assures the retail investor of the basic investor protection provisions. We would not grant a registration to any offshore dealer controlled by a resident of Canada if the resident of Canada could not comply with the ownership restrictions applicable to resident dealer registrants.

4.34 Improving International Position of Resident Dealers. In passing, we underline our hopes that the increase in capital and new relationships that may be secured by Canadian dealers through investment by non-resident investors will allow Canadian dealers to improve their position in the international markets. Canadian dealers may therefore respond to the financial needs of Canadian issuers, not just in domestic markets, but in other markets and perhaps even increase their share of the market for serving the offshore financing needs of Canadian issuers.

EXTENDING THE THEORY OF PROTECTED FUNCTIONS TO THE EXEMPT MARKET

4.35 The Theory of the Protected Functions. In the Discount Access Report, we concluded that the new issue or underwriting business should be the exclusive preserve of

the securities industry. We also concluded that the protection of the underwriting business should be extended to full service brokerage which we believe is essential to the performance of the underwriting function. The theory of the protected functions is simply a product of the overriding policy objective of maintaining the organization of our financial system in separate components performed by separate groups of companies. The Discount Access Report describes in greater detail the functions of the securities industry component of the financial system that should be protected from infringement by other participants in the financial system. Our policy should be consistent in both the exempt and regulated markets.

4.36 Universal Registration for Underwriting and Full Service Brokerage. We believe that the theory of the protected functions should logically and in policy terms be extended to the underwriting of corporate securities in the exempt market. We therefore propose a regulation which would deny the registration exemptions in paragraphs 3, 4 and 5 of subsection 34(1) of the Act for trades in securities to any person or company who acts as an underwriter. This means that such exemptions as those for seed capital and government incentive securities and the exemption for government guaranteed securities would not be affected. The JSIC advised that underwriting in the exempt market of corporate securities by companies, other than registrants, is at a nascent stage and that the JSIC proposal for a universal registration system, which would include universal registration for underwriting and full service brokerage, would have a limited effect.[11] If this is not correct, the

[11] A statistical analysis by Commission staff of all exempt financings reported on Form 20 in the second quarter of 1984 ($1,259,000,000) indicates that some 96% ($1,204,000,000) of the value of the financings was effected using the exemptions for specified financial institutions, exempt purchaser and $97,000 private placements. Of this amount, 35% involved transactions where financial agents were involved, 29% being agents who were registrants and 6% being agents who were not registrants.

Commission may have to consider, on a case-by-case basis, requests for exemptions for particular activities which are now carried on by non-registrants relying on the exemptions. However, the Commission reiterates its belief that underwriting of corporate securities, whether in the exempt or regulated market, should only be carried on by registered dealers. The application of a universal registration system to full service brokerage may be academic in that trades of listed securities whether in the exempt or regulated markets would normally be effected through a stock exchange and only members of the exchange, which are required to be registered under the Act, can effect trades through the exchange.

4.37 Activities of Financial Institutions Outside the Protected Functions. Under the Commission's recommended model the ownership restrictions would apply to all classes of registrant under the Act, other than adviser and the two new categories of registration recommended in the model, i.e. the foreign dealer registration and the international dealer registration. The result would be that financial institutions will not be able to obtain any class of dealer registration. But this result would be too extreme and is unintended. Our model should therefore vest in the Commission the discretion to grant a limited registration to a financial institution if the Commission is satisfied that the activity for which registration is sought will not materially affect the performance of the protected functions by securities firms. This was our approach in the Discount Access Report where the Commission concluded that to grant a registration to a chartered bank which proposed to provide access to discount brokerage would not materially affect the performance of the protected functions by the securities industry. This would also be the case for the type II registration currently available to banks. Indeed, the securities related activities of chartered banks were discussed at some length in the Discount Access Report. The relevant extract from the Discount Access Report is attached as Appendix 10. Under the Bank Act (s.190(5)) a bank can

act as a member of a selling group in connection with an underwriting of securities issued by a corporation. This activity which takes place outside the underwriting and banking group is not considered to be an activity of an underwriter under the Securities Act, the definition of which does not incude "a person or company whose interest in the transaction is limited to receiving the usual and customary distributors' or sellers' commission payable by an underwriter or issuer...." (s.1(1)43(i)). Therefore the Commission would, in the absence of some unusual circumstance, grant a registration to a bank wishing to act as a member of a selling group in a corporate underwriting. To date such registrations have only been granted on a transaction-by-transaction basis.

4.38 Activity of Financial Institutions in the Exempt Market. With respect to the exempt market, subsection 190(7) of the Bank Act limits a bank's involvement in a private placement to securities which a bank can underwrite. The Discount Access Report suggests that with a combination of registration exemptions in the Securities Act and Regulations it might be possible for a bank to act without registration as an agent in connection with a corporate private placement. The Discount Access Report proposes an amendment to the Securities Act and the Regulations to ensure that a combination of exemptions cannot be relied upon by financial institutions wishing to carry on a private placement agency business. We do not anticipate that this recommendation, which is endorsed and assumed by this Report, will conflict with the Bank Act which, as noted above, limits a bank's involvement in a private placement to securities which a bank can underwrite, and allows a bank to underwrite government debt and to act as a member of a selling group in connection with an underwriting of corporate securities. These activities would either be exempt from the registration requirements or fall outside the definition of underwriting in the Securities Act.

4.39 Financial Institutions Giving Investment Advice. By not applying the ownership restrictions to the adviser category of registration, the Commission's model accommodates the power of banks under the Bank Act to give investment advice on a casual basis for no monetary consideration and the traditional activity of some of the other financial institutions, such as the activity of a trust company in giving advice to an in-house pooled fund. Whether such activities will require a registration as an adviser under the Act depends upon the availability of the adviser exemption in section 33 of the Act.

NETWORKING

4.40 Our understanding of networking is the distribution of products of one group of participants in the financial system by another group of participants in the financial system. We support in principle the concept of networking and believe that it is an appropriate offshoot of a segregated financial system. If there is a demand for a so-called "supermarket" of financial services it is difficult for our financial system, organized on a segregated basis, to respond to this demand. Networking does provide an opportunity for innovation which will allow a participant in the financial system to distribute a broader range of financial services.

4.41 Director's Approval of Networking. Any registrant which proposes to distribute products of another group of participants in the financial system will be required to obtain the approval of the Director before proceeding with the proposal. The Director will assess the proposal to ensure that investor protection concerns are adequately addressed. The Director will also assess the proposal to ensure that the concerns underlying the segregated financial system are not significantly compromised by the proposal. In assessing the proposal the Director will generally consult with the SROs although the SROs will not have a veto

over a networking proposal. As soon as possible after the Commission has developed experience with networking proposals, it will publish the conditions which such proposals must satisfy in order to eliminate the requirement for advance approval by the Director.

4.42 Certain Provisions of the Dual Licensing Policy Repealed. Policy 4.5 of the Commission entitled "Dual Licensing of Life Insurance Agents" already contemplates a form of networking - the distribution of mutual fund products by life insurance agents or investment contract salesmen. This Policy will be retained. However, the requirement that the mutual fund dealer and the approved insurer or investment contract issuer must be subject to common ownership or control and restricted to offering the securities and contracts issued by the companies controlled by the common parent will be repealed. Similarly, the requirement for the exclusive contractual agreement referred to in the Policy will also be repealed.

ADVISERS

4.43 Removal of Non-resident Restrictions on Advisers. The Commission has decided that the ownership restrictions applicable to non-residents should not apply to registrants in the category of adviser. The current non-resident ownership restrictions would appear to apply to all registrants. It is our belief that the non-resident ownership restrictions should be applicable only to registrants in the dealer category which includes brokers (members of the TSE) and investment dealers (members of the IDA). There are two reasons for this. First, we believe that advantages which non-residents may have over resident firms, such as access to large pools of capital, are not significant in the provision of investment advisory services, but could be significant in the provision of underwriting and brokerage services. The second reason is that we believe that it is primarily the underwriting and brokerage functions which

make the securities industry a key sector of the economy, requiring protection against non-resident domination. Although the provision of investment advice is an important component of the capital formation process, at the present time we do not perceive any threat of domination by non-residents of the business of providing investment advice. Accordingly, using our free market approach, there is no need for extending the protective net of ownership requirements beyond dealer registrants.

4.44 **Adviser Ownership Limitations Applicable to Financial Institutions.** Because advisers are not members of the SROs they have not been subject to the ownership limitations upon financial institutions. Similarly, it is our understanding that financial institutions have historically provided investment advice. (Our definition of protected functions includes underwriting and full service brokerage but does not include the provision of investment advice unless, of course, the provision of investment advice is linked through a networking arrangement with the provision of brokerage services). It is our view, therefore, that a financial institution should not be precluded from providing investment advice.

4.45 **Monitoring of Investment Advisers.** The Commission should monitor the registrations which it grants in the category of adviser to record the extent of involvement of financial institutions and non-residents in the business of giving investment advice. If, for example, there occurs a radical departure from the present practice the Commission might have to consider the implications and propose an appropriate regulatory response.

4.46 **Offshore Mutual Funds in Canada.** A peripheral issue was raised at the Meeting concerning the marketing of units of mutual funds managed and based outside Canada. The issue which arises is whether the requirements applicable to mutual funds in Canada should be applied to mutual funds

which are promoted to comply with the laws of a foreign jurisdiction. It is apparent that if the Canadian requirements are applied rigidly, then mutual funds founded in other jurisdictions will simply not be offered in Canada. The Investment Funds Institute of Canada ("IFIC") has provided the Commission with a draft of a policy which would address some of these concerns. We have directed our staff to review the local requirements applicable to mutual funds which offshore mutual funds have difficulty satisfying to ascertain whether these requirements can be varied while maintaining an acceptable level of investor protection. It may be as a result of this review that the Canadian requirements generally can be revised in co-operation with the administrators in the other provinces. IFIC has also asked the Commission to request of the U.S. Securities and Exchange Commission reciprocal treatment of Canadian funds sought to be marketed in the United States. The Commission will pursue the request of IFIC in this regard.

4.47 Diversification. This Report does not address investment by dealer registrants in financial institutions and other businesses. Until this question becomes more pressing the Commission will follow Policy 4.1 which requires the consent of the Commission and the SROs of which a dealer is a member before any significant diversification into other financial businesses can occur.

CONCLUSION
PART V

5.01 The model which the Commission has recommended to the Government is intended as a package, with the exception mentioned in 5.02. There are four integrated components of the model:

(i) the 30% ownership limitation coupled with the 51% significant industry investor requirement which is applicable to all outside investment in the securities industry;

(ii) the admission to Ontario of subsidiaries of a limited number of non-resident securities firms, each subject to a capital limitation and all subject to an aggregate capital limitation;

(iii) the code regulating access by Canadian issuers and investors to the international markets; and

(iv) the extension of the ownership restrictions to the performance of the protected functions, i.e. underwriting and full service brokerage, in the exempt market.

5.02 It would, in our view, be possible to reserve action concerning the involvement of financial institutions and other resident investors in the capital markets and proceed with the recommendation concerning direct investment by non-residents in securities firms, direct entry of non-resident firms, and the code concerning access of Canadians to the international markets, provided that ownership restrictions are extended into the exempt market. We believe that this "unpackaging" of the model should not be necessary.

5.03 Our model is not motivated by a concern that the Canadian securities industry is not efficiently serving the needs of Canadian issuers and investors. On the contrary, we believe that Canadians are generally well served by a highly competitive and capable domestic securities industry. However, it does not follow that because Canadians are generally well served by the securities industry no change should be made in the restrictions concerning outside involvement in the industry. Instead, we took the approach that there should be as few restrictions as possible concerning entry into the securities industry while at the same time respecting the overriding public policies concerning the financial system. We are confident of the ability of the industry to respond to the changes in the environment which will flow from implementation of our model.

5.04 In this Report we did not believe it was necessary to re-examine the public policy of whether the securities industry should be substantially Canadian. As is apparent throughout the Report, we accepted this as Government policy. We did, however, consider the manner in which this policy is reflected in our scheme of securities regulation. Similarly, we believe that the four pillars principle is respected by the Commission's model and yet improved access to capital is made possible under our recommendations.

5.05 It is important to note that simply because our proposals for limiting ownership by financial institutions in securities firms are less restrictive than the existing scheme of regulation does not mean that our model is a transitional model from strict separation of the groups within our financial system to full integration of our groups in the financial system. As we have said in the

Report, any overhaul of the four pillars principle which may result from the Ontario Task Force on Financial Institutions and the other studies which are underway, may require a rethinking of our model as it applies to financial institutions and other commercial enterprises. However, if the four pillars principle survives the current assault from studies and private sector testing, we believe that our model should also survive.

5.06 We are hopeful that our model avoids any constitutional issues at this stage, although there is certainly the potential for constitutional concerns arising in connection with any study of the financial system because of the various jurisdictions governing the activities of financial institutions.

5.07 We believe that our model directly, and by virtue of the residual discretion vested in the Commission, accommodates the activities of the chartered banks currently authorized by the Bank Act. If the Bank Act is amended to extend the authorized activities of the chartered banks, particularly into the area of protected functions, then a conflict may arise between provincial securities legislation and federal banking legislation.

5.08 Any conflict which now exists between the governing legislation applicable to other financial institutions and the Commission's recommended model will have to be dealt with by the Commission on a case-by-case basis and, if need be, by the courts construing the respective powers of the jurisdictions regulating the financial institutions and the powers of the Commission. This concern will of course become academic if the federal and provincial governments are able to adopt a legislative framework for the financial

system which is consistent from jurisdiction to jurisdiction and is consistent from statute to statute within each jurisdiction.

5.09 We referred to the discretion of the Commission in resolving conflicts between jurisdictions. The Commission's discretion is vital to the operation of the model, not only in resolving jurisdictional conflicts but, in particular, in granting the registrations and setting the capital limits for the foreign dealers. The model assumes that the Commission will exercise its discretion to ensure a substantially Canadian securities industry which is structured to respond to the concerns underlying the four pillar principle. It would be preferable to have more precision and less discretion, but at this stage we doubt that is possible. Until the Commission develops more information concerning the interest of non-resident securities firms in the Canadian capital markets and the activities in which these firms are involved, it will be difficult for the Commission to recommend specific regulations. In the interim, the Commission will publish its thinking concerning the exercise of its discretion provided for in the model.

5.10 In addition to publishing a policy concerning the circumstances in which it may be prepared to exercise its discretion, the Commission must also review the operation of the model on an ongoing basis. In particular, the Commission should assess the impact of the new class of registrant - the foreign dealer - as suggested above, to determine whether the restrictions which will be imposed upon these registrants can be relaxed. In addition, the Commission will monitor the non-resident involvement in the provision of investment advice. The model does not contemplate any ownership restrictions on investment advisers because that

component of the securities industry is largely in the hands of resident advisers and the threat of a substantial involvement by non-residents is apparent. However, if non-residents do become a substantially greater factor in the provision of investment advice in Ontario the Commission must be ready to reassess its recommendations and react appropriately.

5.11 The Commission must remain conscious of other developments concerning the organization of the financial system and the powers and the activities of other participants in the financial system and how the exercise of these powers or the performance of these activities could affect the capital markets. It is a fluid situation but the Commission is well placed to react quickly and in the public interest.

5.12 We would like to thank all of the participants in the study. In particular, we would like to recognize the invaluable input to the study of the Joint Securities Industry Committee and the willingness of the Committee to assist the Commission at all stages of the study. We also wish to thank the many others who submitted written briefs, those who participated in the Meeting with the Commission and their counsel. We also wish to acknowledge the able contributions of our staff led by Harry Malcolmson and of the Chairman's legal assistant, William Ainley, and of our counsel, Messrs. Ed Waitzer and John Stransman of the law firm Stikeman, Elliott.

5.13 In conclusion, we emphasize that our task is not to exercise our powers to protect any particular group of participants in the capital markets. Our responsibility is to create a structure which encourages the efficient

operation of the capital markets. We believe that in the recommendations we have made the principal beneficiaries will be the Canadian issuers and the Canadian investors who will be better served by our market intermediation system.

Dated as of January 31, 1985 Toronto, Canada

Chairman Vice-Chairman

Appendix 1

Status at December 31, 1984 of

"Grandfathered" Non-Resident Firms Registered as Dealer

Name of Firm Grandfathered as Dealer in 1971	Membership in 1971		Status today, indicates changes in name and in IDA or TSE Membership
	IDA	TSE	
1. Bache & Co. Inc.	Yes	Yes	Bache Securities Inc. TSE/IDA
2. Baker, Weeks of Canada	Yes	Yes	Dean, Witter, Reynolds (Canada) Inc.
3. A. G. Becker (Canada) Ltd.	No	No	Registration surrendered
4. Charterhouse Securities of Canada Ltd.	No	No	No change
5. Canandian American Financial Corp.	No	No	Canadian American Financial Corp. (Canada) Limited
6. Dean, Witter International Inc.	No	No	Registration surrendered
7. Dominick Corporation of Canada Ltd.	Yes	Yes	TSE only
8. Drexel Firestone (Canada) Ltd.	No	No	Registration surrendered
9. duPont, Glore Forgan Canada Ltd.	Yes	Yes	" "
10. Chas. King & Co.	Yes	Yes	" "
11. Laidlaw & Co., Inc.	No	Yes	" "
12. Merrill Lynch, Pierce, Fenner & Smith of Canada Ltd.	Yes	Yes	" "
13. Merrill Lynch, Pierce, Fenner & Smith, Inc.	Yes	No	" "
14. Royal Securities Corporation Ltd.	Yes	No	Merrill Lynch Canada Inc. IDA/TSE
15. Netherland Overseas Corporation Canada Limited	No	No	Registration surrendered

Name of Firm Grandfathered as Dealer in 1971	Membership in 1971 IDA	Membership in 1971 TSE	Status today, indicates changes in name and in IDA or TSE Membership
16. J. R. Timmins & Co.	Yes	Yes	Registration surrendered
17. Swiss Corporation for Canadian Investments Ltd.	No	No	" "
18. Triarch Securities Corporation	No	No	" "
19. Corporate Investors (Marketing) Ltd.	No	No	" "
20. Diversified Investment Services Ltd.	No	No	" "
21. Dreyfus Sales of Canada Ltd.	No	No	" "
22. J & H.W.F. Equity Corporation Ltd.	No	No	" "
23. Lifetime Financial Services Ltd.	No	No	" "
24. Planned Investments Corporation	No	No	" "
25. Prudential Fund Management Canada Ltd.	No	No	No change
26. United Investment Services Ltd.	No	No	Canadian owned.

Note:

1. In 1976 the Commission approved the change of control of Baker, Weeks of Canada Ltd. from Baker, Weeks & Co. Inc. to Reynolds Securities Inc. The registrant subsequently changed its name to Reynolds Securities (Canada) Ltd. In January 1978, Reynolds Securities Inc. merged with Dean Witter & Co. to form Dean Witter Reynolds Inc.

   On November 1, 1978 Regulation 794 was amended to allow for the continued registration of Dean Witter Reynolds (Canada) Inc. to June 30, 1979 and subsequently Regulation 804/79 extended the Registrants' registration to January 31, 1980.

Thereafter, Regulation 531/80 promulgated subsection 134(5) of Regulation 910 which permitted renewal of registration of the non-resident controlled registrant until September 30, 1984 and contemplated conditions of registration being imposed by the Commission. At this time Dean Witter Inc. sold 50% of its shares to three Canadian resident employees of the Registrant and agreed to sell the balance of its shares to these Canadians by September 30, 1984.

During 1983 the Registrant applied for an extention of the period for Canadianizing its ownership to September 30, 1989 and agreed, in return, to sell at least a further 40% of the voting shares of the Registrant to Canadians while retaining 50% of the equity shares. In response, Cabinet promulgated Regulation 286/84 permitting renewal of registration of the Registrant notwithstanding the foreign ownership restrictions of subsection 133(1) of Regulation 910 until September 30, 1989. Subsection 134(5) of Regulation 910 relating to foreign controlled registrants was revoked effective October 1, 1984. Dean Witter Reynolds (Canada) Inc. has applied for and received a renewal of its registration. Specific conditions attach to its registration including compliance with the ownership restrictions of the foregoing regulations, restrictions on its ability to act as an underwriter and prohibitions on using the capital or credit of its associates and affiliates.

Appendix 2

Status at December 31, 1984 of

Grandfathered Non-Resident Firms Registered as Adviser

Name of Firm Grandfathered as Adviser in 1971	Category in 1971	Status Today
Babson's Canadian Reports Ltd.	Investment Counsel	Registration surrendered
Bolton Tremblay & Co.	Investment Counsel	Investment Counsel and Portfolio Manager; 100% Canadian owned
Harris & Partners Investment Advisory Service Ltd.	Investment Counsel	Registration surrendered
Loomis, Sayles & Company (Canada) Ltd.	Investment Counsel	Investment Counsel Portfolio manager and Mutual fund dealer; 100% Canadian owned (North American Life Assurance Company)
Scudder, Stevens & Clark of Canada Limited	Investment Counsel	Investment Counsel; 100% foreign owned

Appendix 3

Non-Resident Owned Advisers

As at December 31, 1984

Current Non Resident Owned Advisers: Investment Counsel with or without Portfolio Management

Aetnavestor Inc.

Scudder, Steven & Clark of Canada Limited

Domlife Investment Management Limited

Paramet Corporation Ltd.

The Putnam Management Company, Inc.

Ruggles & Crysdale, Inc.

APPENDIX 4

PUBLIC DISTRIBUTION OF SECURITIES OF REGISTERED DEALERS

1. First Marathon Securities Limited ("FMS")

In February 1984, First Marathon Inc. ("FMI"), the parent corporation of FMS, which is registered under the Securities Act, offered its shares to the public. At the time of the issue, 5,000,000 common shares of FMI were held by the former shareholders of FMS. 1,250,000 common shares or 20% of the shares of FMI to be outstanding after giving effect to the issue, were offered to the public through a prospectus filed in Ontario, among other jurisdictions. No other class of shares of FMI was outstanding at the time of the issue.

2. Midland Doherty Limited ("MDL")

In June 1983, Midland Doherty Financial Corporation ("MDFC"), the investment holding company of MDL which is registered under the Securities Act, offered its shares to the public. At the time of the issue, 4,269,474 common shares of MDFC were held by the former shareholders of MDL. 800,000 common shares, or approximately 16% of the shares of MDFC to be outstanding after giving effect to the issue, were offered to the public through a prospectus filed in Ontario, among other jurisdictions. No other class of shares of MDFC was outstanding at the time of the issue.

3. Walwyn Stodgell Cochran Murray Limited ("WSCM")

In March 1983, Walwyn Inc. ("WI"), the investment holding company of WSCM which is registered under the Securities Act, offered its shares to the public. At the time of the issue 4,076,900 common shares of WI were held by the former shareholders of WSCM. 1,000,000 common shares, or approximately 24.5% of the shares of WI to be outstanding after giving effect to the issue, and warrants to purchase a further 500 common shares, were offered to the public through a prospectus filed in Ontario, among other jurisdictions. No other class of shares of WI was outstanding at the time of the issue.

4. McNeil Mantha Inc.

In April 1984, McNeil Mantha Inc. ("MMI"), which has since become registered under the Securities Act, offered its shares to the public in the Province of Quebec. At the time of the issue, 2,672,520 common shares of MMI were held by the directors, officers and employees of MMI. 1,000,000 common shares, or approximately 27% of the shares of MMI to be outstanding after giving effect to the issue, were offered to the public through a prospectus filed in Quebec. No other class of shares of MMI was outstanding at the time of the issue.

APPENDIX 5

PART 1

MAY 2nd, 1984.

POLICY REVIEW: COMPETITIVE POSITION OF THE SECURITIES INDUSTRY IN DOMESTIC AND INTERNATIONAL FINANCIAL MARKETS

Background

One of the goals of securities legislation in Ontario is to provide a framework that promotes the mutual objectives of the securities industry, issuers and investors. In recent years domestic and foreign securities markets have undergone major structural changes. Price and service competition amongst the entities providing financial services has increased substantially. Technological advances and industry innovation are quickly eroding traditional geographic and product barriers and are putting increased pressure upon regulatory barriers. Canadian issuers have increased their demands to access markets abroad and to access Canadian markets with utmost speed. Canadian investor institutions have become significant participants in international capital markets. This evolution of the demands and needs of securities market participants is natural and vital for the continuing viability of the Canadian capital markets. It is essential that the Canadian securities industry be allowed and encouraged to maintain its presence amongst the most innovative and competitive market intermediaries in the world. The Commission must ensure that the regulatory framework it administers remains relevant to and facilitates this process.

Sources and adequacy of capital have always been a major policy concern for the securities industry. In July 1971, immediately following the publication of a Joint Industry Committee position paper which reviewed the previous report of the industry's Committee to Study the Requirements and Sources of Capital and the Implications of Non-Resident Capital for the Canadian Securities Industry, the Province of Ontario provided by regulation to the Securities Act that non-resident ownership of new registrants would be limited to 25% with no single non-resident or assoicated group of non-residents holding more than 10%. In his statement to the Legislature concerning the regulation, the Premier of Ontario noted the Government's decision to restrict the entry into the Ontario investment community of non-Canadian residents and to limit the growth of existing non-Canadian resident firms, recognizing the

key role of the securities industry in the national economy and the perceived threat of foreign domination or control thereof. The regulation was revised to substantially its present form in 1974, following the 1972 Report of the Ontario Securities Commission Securities Industry Ownership Committee, which has been established by the Commission, at the request of the Premier, to review capital requirements and foreign ownership in the Ontario securities industry. The present form of the regulation continues the restrictions upon non-resident investment in new registrants and imposes conditions upon those non-resident firms which were registered in Ontario at the time the restrictions were enacted. The number of so-called grandfathered non-resident firms has declined significantly since the imposition of restrictions upon non-resident ownership. Since 1971, the regulation has been the subject of numerous applications, hearings and reviews.

The Securities Industry Ownership Committee anticipated that, notwithstanding the regulation, a "back door" to the Canadian securities market remained open by virtue of the provisions of the Securities Act which provide exemptions from the registration requirements of the Act. The Committee commented that:

> "The exemption permits non-registrants to trade without the necessity of Ontario registration with sophisticated classes of the investment public - including banks, loan and trust companies, insurance companies, and 'recognized' exempt purchasers. The exemption was created long before the institutional investor became such a powerful force in the marketplace."

This concern as to the efficacy of the regulation was echoed by the Commission in its 1979 Report to the Minister of Consumer and Commercial Relations on the Application of Ontario Securities Legislation to Non-Resident Securities Firms Not Currently Registered in Ontario. At that time, the Commission recognized that substantive issues had arisen as to the extent to which non-registered non-resident owned dealers should be permitted to operate in Ontario through exemptions from registration. The Commission proposed some short term recommendations, and suggested a thorough review of its own recommendations as well as other questions relating to ownership restrictions in three years. The recommedations have not been reflected in the regulation and the suggested review has yet to be undertaken by the Commission although related issues have been considered by the Commission, both generally and in the context of specific applications.

The exemptions from the registration requirements of the Act not only have an impact upon the ability of the Government to implement ownership policies but also affect the ability of the Commission to regulate activities generally which impact upon the capital markets. It is possible for any person or company, whether a resident or a non-resident, whether a financial institution or not a financial institution to carry on activities relying upon the exemptions from registration and thereby operate generally outside the ambit of the Commission.

In 1981, the Commission held a hearing with respect to public ownership of securities dealers and subsequently adopted Policy Statement 4.1. Following a hearing on the issues of institutional ownership of and diversification by securities dealers, the Commission issued a report to the Minister of Consumer and Commercial Relations in December 1982. In October 1983, following a lengthy public meeting, the Commission issued a Report on the Implications for the Canadian Capital Markets of the Provision by Financial Institutions of Access to Discount Brokerage Services.

The Toronto Stock Exchange and the Investment Dealers Association of Canada (collectively, the "SROs") have recently been asked to consider a proposal by a leading Canadian broker-investment dealer which would have the effect of insulating from regulation and ownership restrictions significant portions of the dealer's business. Other efforts to avoid such ownership restrictions, particularly by non-resident financial service firms, through reliance upon exemptions from registration requirements have become common. The proposal of the Canadian dealer, however, suggests the sophistication of participants in the Canadian securities industry, who are aggressively seeking access to capital as well as other resources, expertise, and business opportunities by developing new relationships internationally.

Policy Review

Accelerated change in the structure and regulation of the financial services sector has caused the Commission and the SROs to undertake an immediate, considered policy review of the adequacy and relevance of the regulations governing the ownership of securities firms, particularly insofar as such regulations may impact on access to capital by, and the competitive strength of, the securities industry. The policy review will include a consideration of the impact of the exemptions from registration upon the Commission's ability generally to regulate the activities of participants in the capital markets.

The need for coordinated regulatory reform in the financial services sector has already led to the initiation of several broader policy reviews. The Government of Ontario announced in its most recent Throne Speech the appointment of a task force to inquire into the needs of the Province's financial system and its users. At the federal level, an advisory committee to the Minister of Finance has been constituted to consider the organization and regulation of the financial system in Canada. It is the Commission's intention that its policy review complement such initiatives but it would focus upon the role of capital market intermediaries within the financial system.

The Commission study will serve as the focus for public discussion and assist it in advising the Government of Ontario. The SROs, who share the Commission's concerns in this area, have indicated their intention to establish a Joint Industry study that will coordinate its efforts with those of the Commission. The two studies, and related research, will proceed cooperatively. Cooperation with other bodies exploring public policy concerns in this area will be encouraged.

The range of issues to be considered by the Commission and Joint Industry studies will focus on the desire of the Commission and the SROs to look ahead and consider how best to ensure the continued strength and competitive position of the Canadian securities industry, domestically and in international financial markets.

Public policy in Ontario remains committed to preserving Canadian control of the securities industry and to limiting the involvement of financial institutions as investors in securities firms. The Commission's inquiry will review opportunities for regulatory reform having regard for these underlying policy objectives. By considering, prospectively, the mutual requirements of participants in Canadian capital markets, the Commission and the SROs hope to be in a position to ensure that government policy remains relevant to and supportive of this key sector of the Canadian economy. Specific considerations will include:

Should public policy concerning ownership of the Canadian securities industry be recognized through the registration requirements of the Securities Act, particularly if significant parts of the business of the securities industry can be carried on without registration? Alternatively, should ownership policies apply to any company carrying on a securities business in Canada, whether or not otherwise exempt from the registration requirements of the Act? To what extent is it desirable for the Commission to regulate activities, "exempt" or otherwise, that involve or affect Canadian capital markets?

Do and will existing policies concerning ownership and sources of capital for the securities industry assist or hinder the objectives of the industry in its ability to serve Canadian issuers and investors, attract capital, innovate and compete domestically and internationally?

How can the Canadian securities industry participate in international financial markets to its full potential and to what extent can or should the domestic regulatory framework encourage such initiatives?

Are the 1982 recommendations of the Commission to the effect that financial institutions be prohibited altogether from investing in securities firms appropriate in view of the pressures upon financial institutions and securities firms to compete for the funds of investors and savers? Similarly, does the 10% limitation upon non-resident ownership by any one person enhance or restrict the opportunities of Canadian securities dealers, issuers and investors domestically and abroad?

Having regard for current developments, could revisions be made to existing ownership restrictions or a different regulatory approach create benefits for the industry and its "consumers", without compromising the basic regulatory framework and the continuing need to ensure domestic control of our financial markets?

Process

The Commission has retained Edward Waitzer and John Stransman of Stikeman, Elliott as Commission Counsel to assist Commission staff in undertaking the proposed study, coordinate with the Joint Industry effort and other related initiatives, and to act as counsel at a public hearing which will be convened by the Commission in September 1984. It is intended that the Commission staff and Joint Industry Studies will be available prior to that hearing and will serve as the focus thereof. Commission counsel are meeting with representatives of the SROs with a view to establishing a coordinated research agenda and schedule and encourage other interested parties who may have views or proposals relevant to the study to contact them. Progress reports and specific requests for comments may issue from the Commission or the Joint Industry Committee during the course of their research activities.

For Further Information
Contact: Peter J. Dey
Chairman,
Ontario Securities Commission
(416) 963-0211

Appendix 5

Part 2

ONTARIO SECURITIES COMMISSION
SECURITIES INDUSTRY POLICY REVIEW
PRELIMINARY ISSUES PAPER

A. BACKGROUND

By press release dated May 2, 1984 (the "Press Release"), the Commission announced its intention to undertake a policy review of the adequacy and relevance of the regulations governing the ownership and registration of securities firms. At the same time, a committee of the Canadian Stock Exchanges and the Investment Dealers Association of Canada (the "Joint Industry Committee") was constituted to conduct a similar review. The Commission wishes to encourage broad participation in the review process, both prior to and in connection with the public meeting which the Commission intends to convene in September. In order to facilitate and focus such input the Commission has prepared this preliminary issues paper, designed to give some indication of issues which are of immediate concern to the Commission. Such concerns may be modified or augmented with the benefit of submissions from interested parties.

On June 13, 1984, the Minister of Consumer and Commercial Relations announced the composition of the task force, to be chaired by Professor Dupre, to examine the organization and operation of financial institutions in Ontario. That task force has stated that it intends to release an interim report by the end of 1984, which will identify the general issues it intends to examine and will propose a consultative process for carrying out its investigation. The Commission's focus will be more specific than that of the task force, considering the issue of outside involvement in the securities industry from the perspective of the industry and capital market efficiency rather than from the perspective of other financial institutions. The Commission intends to publish its recommendations in later 1984 and will provide materials generated by its review to the task force.

B INTRODUCTION

The Commission's overriding regulatory mandate is to ensure the efficiency of domestic capital markets. This is achieved through a variety of regulatory instruments, including those specifically oriented to investor protection (e.g. disclosure requirements) as well as registration and ownership requirements, whereby the Commission can effectively control the participants in domestic capital markets.

The securities industry (as part of the financial services sector) is in the midst of an era of significant change. Virtually each day announces the introduction of a new product or service; another application of telecommunications or other evolving forms of technology; or another merger, consolidation, combination or cooperative relationship of securities firms, financial intermediaries and others who have hitherto operated outside of what is generally considered to be the financial services sector. Each change triggers others, so that events of far-reaching importance to the structure and composition of the securities industry are occurring at an ever-accelerating rate.

It is essential that the Canadian securities industry be allowed and encouraged to maintain its presence among the most innovative and competitive market intermediaries in the world. For its part, the Commission must ensure that the regulatory framework it administers remains relevant to this process. Failure to do so will, in short order, lead to regulatory gaps and conflicts which could inhibit market efficiency and limit the effectiveness of the Commission.

C. THE ISSUES

In initiating this policy review, the Commission is primarily concerned with three interrelated issues:

1. the sources and quality of capital that will be available to the domestic securities industry to handle future growth, innovate and compete with other providers of financial services;

2. whether and to what extent non-resident, institutional or other non-industry participation in the domestic securities industry is necessary or desirable; and

3. to the extent outside participation is permitted, how and to what extent such activities should be regulated by the Commission.

1. Domestic Securities Industry Capital

The Commission is concerned about the domestic industry's access to capital to meet emerging market challenges, including the ability generally to:

(a) innovate and take advantage of new business opportunities;

(b) deal with turnover problems within the firm in view of limited sources of capital;

(c) ensure continued industry control in the face of a trend towards large firms without any single controlling industry shareholder; and

(d) compete with other participants in the financial services sector.

The Commission intends to consider whether and to what extent existing policies concerning ownership and sources of capital for the securities industry might be reformed to enhance the industry's ability to serve Canadian issuers and investors, both domestically and in foreign markets.

2. Desirability of Non-Industry Participation

The Commission is also interested in exploring the merits of non-industry participation in the domestic securities industry. What, if anything, can non-resident, institutional or other non-industry participants contribute to the securities industry, whether by way of capital, expertise, technology or other resoruces?

The Commission intends to consider ways in which the underwriting and full service brokerage functions of the securities industry can be reconciled with new forms of cooperative business relationships that are emerging within the financial services sector, domestically and on a global level, including:

(a) joint ventures;

(b) agency net-working;

(c) entry of non-financial institutions; and

(d) the introduction of new products which link different types of financial institutions.

The Commission remains committed to the Government's policy objective of preserving a strong domestic securities industry as a key sector of the Canadian economy. In this regard, the Commission intends to reconsider whether the existing regulations are necessary or optimal to constrain institutional dominance and undue foreign influence of the securities industry and, in turn, domestic capital markets.

The Commission is concerned about the impact of the current regulatory framework on competition within the domestic securities industry, including its impact on the trend towards industry concentration and the effect of exemptions from the registration requirements on investor protection. The Commission is also concerned with whether registrants, with their responsibilities under the Securities Act, can compete fairly with those who perform essentially the same function relying upon exemptions from registration.

Finally, the Commission is concerned about the impact of its regulatory framework on international competition, including the access of Canadian issuers and investors to global markets and advisory expertise and the ability of domestic securities industry participants to take advantage of international market opportunities.

3. Reforming the Regulatory Framework

If outside participation in the domestic securities industry is desirable, the Commission must address how and to what extent such participation should be regulated. With the advent of full price competition in April 1983, the Commission's primary instruments for regulating securities industry structure became ownership restrictions and registration requirements. To the extent that such instruments interfere with free market forces, the Commission's desire is to identify the least restrictive, while still effective, regulatory framework.

An increasing proportion of the business of the securities industry is being carried on through exemptions from the registration requirements, both for securities and market intermediaries. To the extent that securities transactions may be effected in reliance upon such registration exemptions, existing ownership restrictions are not effective. The Commission intends to re-examine the extent to which it is desirable to regulate activities, "exempt" or otherwise, that involve or affect Canadian capital markets. The Commission welcomes comment on the benefits to issuers, investors and industry participants of extending or relaxing the current registration requirements as well as the impact of any such reform on entry and ownership restrictions.

In addition, the Commission is concerned about the impact of entry and ownership restrictions on the access of industry participants and Canadian issuers to international markets and business arrangements. What rules, if any, should be applicable to the offshore activities of such Canadian issuers and industry participants? To what extent should the Commission be working towards an internationally integrated regulatory framework?

D INVITATION TO COMMENT

The Joint Industry Committee hopes to respond to the preliminary issues paper with specific proposals by mid-August. In the interim, Commission counsel will also be preparing a policy paper. It is intended that both documents be circulated for discussion and response prior to the public meeting.

Commission counsel would welcome the benefit of comments and submissions in response to this preliminary issues paper and in anticipation of its policy paper and the structuring of a public meeting. Interested parties are encouraged to contact Edward Waitzer (869-5587) or John Stransman (869-5626), Stikeman, Elliott, Suite 1400, P. O. Box 85, Commerce Court West, Toronto, Ontario, M5L 1B9 or Harry Malcolmson (963-0221), Ontario Securities Commission, Suite 1800, P. O. Box 55, 20 Queen Street West, Toronto, Ontario, M5H 3S8.

SECURITIES INDUSTRY POLICY REVIEW

REQUEST FOR COMMENTS IN RESPONSE TO THE REPORT OF THE JOINT SECURITIES INDUSTRY COMMITTEE

I. BACKGROUND

By press release dated May 2, 1984, (OSCB May 4, 1984, p. 1907) the Commission announced its intention to undertake a policy review of the adequacy and relevance of the regulations governing the ownership and registration of securities firms. At the same time, a committee of the Canadian Stock Exchanges and the Investment Dealers Association of Canada (the "Joint Securities Industry Committee" or "JSIC") was constituted to develop specific proposals in response to the concerns articulated in the press release and in a subsequent preliminary issues paper (OSCB June 29, 1984, p. 2766). The Joint Securities Industry Committee has now published its proposals.

As discussed in the preliminary issues paper, the Commission's overriding regulatory mandate is to ensure the efficiency of domestic capital markets.

The effective regulation of an efficient marketplace requires a balancing of interests. The JSIC proposals reflect the viewpoint of one group of domestic market intermediaries and presents a comprehensive regulatory model. The Commission hopes that it will stimulate widespread comment from, and the proposal of alternative regulatory models by, others who participate in and make use of Canada's securities industry and capital markets and whose interests will be affected by the Commission's review.

The Commission must ensure that the regulatory framework it proposes and administers encourages adaptive innovation - of products, processes, applications and marketing technologies, management resources, access to and processing of information, economies of scale and entrepreneurship - in order to ensure that the Canadian securities industry maintains its strong competitive position. In relative terms, the domestic securities industry is highly regulated and faces significant challenges in adjusting to much higher levels of risk, a much faster pace of technological change, and much greater price and non-price competition from both traditional and non-traditional competitors in the emerging global financial markets. These forces are radically changing the nature of

the securities business and have accelerated pressures to deregulate or reregulate entry restrictions. At the same time, the Commission must seek to maintain the integrity of the regulatory framework it administers and, where necessary, remedy gaps and conflicts which inhibit market efficiency and limit the Commission's effectiveness in pursuing its mandate. Similarly, the Commission recognizes that an element of an effective overall regulatory framework is uniformity of legislation among jurisdictions regulating the domestic securities industry. As such, the Commission continues to monitor the approaches being taken or recommended in other jurisdictions.

As noted in the report of the Joint Securities Industry Committee (the "JSIC Report"),

> Government... must provide a regulatory environment in which market participants... can operate freely and effectively, motivated by competition to make the most effective use of their resources... the rules applied should be the least restrictive necessary to attain the desired effects. If government does not regulate it adequately, or over-regulates, public confidence will be eroded, competition will be reduced and financial resources will be withdrawn from financial markets or used inefficiently.

II. JSIC REPORT

Having regard for the foregoing concerns, the JSIC has determined that maintenance of the existing market structure is desirable and that further restrictions on entry, as well as broader regulation of market participants, are required to achieve this objective. Specifically, the JSIC Report recommends the immediate implementation of additional regulations in order to:

(a) maintain the regulatory boundaries which, until recently, delineated the domestic securities industry by requiring universal registration of anyone performing a market intermediary function;

(b) preserve the separation of functions between market and financial intermediaries; and

(c) seek to ensure separation of functions between domestic and international capital markets and securities industries.

The JSIC Report presents a coherent regulatory approach and includes detailed and complex proposed regulations and other rules to implement the JSIC's recommendations. A brief summary of the regulatory objectives and instruments recommended by the JSIC Report follows.

A. Universal Registration and Non-Industry Ownership Restrictions

The JSIC Report focuses on the "problems" created by the conduct of market intermediation activities by unregulated organizations and by financial intermediaries in reliance on the registration exemptions in Ontario's securities law. Aside from concerns as to how such activities might erode the separation of market and financial intermediation functions, the JSIC is of the view that reliance on registration exemptions poses threats to investor protection and gives rise to unequal competition.

To resolve these concerns, the JSIC Report recommends that all those acting as market intermediaries (i.e. performing the function of directly linking users and investors of funds), both in the primary and secondary markets, should be required to register with the Commission and to comply with the full range of applicable regulatory requirements, including ownership restrictions. Further, the JSIC Report recommends that existing rules of the self-regulatory organizations affecting the extent of non-industry investment in market intermediaries should be imposed on all registrants by government regulation. The JSIC Report recommends that industry ownership rules be relaxed to allow a registrant to issue to a non-industry investor, including a non-resident, non-voting securities that carry up to 10% participation in the earnings of the firm, subject to reduction by the percentage of votes held and to a 25% aggregate limit for non-residents.

B. Separation of Functions

The combination of registration requirements and domestic industry ownership rules would, in the view of the JSIC, better enable the Commission to guard against encroachment on market intermediation activities by financial intermediaries (i.e. banks, trust and life insurance companies and others) through affiliated entities or through their ability to influence unregulated organizations. The JSIC Report also recommends that financial intermediaries be restricted to carrying out market intermediation activities necessary for the effective performance of their financial intermediation functions. Such activities would, in the view of the JSIC, include participation in consortium lending arrangements; distribution of their own securities and those

of controlled subsidiaries; distribution of registered retirement savings plans and in-house mutual funds; and realization of securities pledged as collateral.

The JSIC Report recommends that securities firms should continue to be precluded from carrying on business as a bank, trust company or insurance company. The JSIC Report recognizes certain constitutional concerns should a province attempt to exclude the banks from activities specifically permitted by the Bank Act.

The JSIC Report recommends networking arrangements as a means of maintaining the separation of functions while allowing for the effective use of distribution facilities and, if thought desirable, the development of "one-stop" financial service availability. Rather than prescribe guidelines as to the types of permissible networking arrangements, the JSIC Report concludes that such arrangements should be subject to the right of the self-regulatory organizations, as well as securities administrators, to receive advance notice of any proposed arrangement and to object if they consider it might give rise to detrimental results.

C. Separation of Markets - Non-Resident Ownership Restrictions

While recommending that all market intermediation activities require registration, the JSIC Report advocates the maintenance of existing non-resident (as well as industry) ownership restrictions as the most effective means to ensure retention of a Canadian-controlled securities industry. The continued ability of non-resident owned firms to rely on the registration exemptions would, in the view of the JSIC, lead to a range of entrants concentrating on institutional transactions in the domestic markets and thereby eroding the "tripartite range of alternatives for Canadians upon which much of the analysis in this (JSIC) report is premised" (i.e. financial and market intermediaries in Canada and access to others outside Canada). The JSIC Report recommends against allowing non-resident entry in order to safeguard against their establishing a dominant position in the comparatively small Canadian market or their failing "to give adequate recognition to the distinctive nature of the Canadian marketplace and economy" in providing advice to their clients.

The result of the JSIC's recommendations would be to deny non-resident firms entry into Canadian capital markets or access to Canadian issuers and investors except:

(a) to accept an unsolicited order outside Ontario from an Ontario resident;

(b) to sell to designated institutions securities that are in the course of a distribution primarily made outside Canada;

(c) to sell "foreign" securities (i.e. issued by an issuer organized outside Canada or, in respect of issuers organized in Canada, securities originally distributed outside Canada so long as no active trading market exists with respect to such securities in Canada) to designated institutions in Ontario;

(d) to trade in interlisted securities for designated institutions, if the non-resident firm is a member of a foreign stock exchange and if it files appropriate undertakings to comply with Canadian law; and

(e) to assist Canadian issuers distribute their securities outside of Canada.

III. PRELIMINARY CONCERNS OF COMMISSION COUNSEL

Financial services, precisely because they are not strongly dependent on comparative advantages in the usual sense (e.g. natural resources or climate endowments) are highly sensitive to the regulatory environment. The Commission recognizes that slight changes in the regulatory framework may have substantial impact on the nature or viability of certain activities in the domestic capital markets. The JSIC Report advocates a comprehensive regulatory approach. Neither the Commission nor its staff have had an opportunity to carefully analyze and consider the report and recommendations of the JSIC. However, having regard for the interactive process between regulation and financial innovation, and in the interests of stimulating widespread response to the JSIC Report, Commission counsel raise the following preliminary issues for consideration.

A. Universal Registration to Maintain Boundaries

While the Commission has recognized the utility of regulations designed to maintain barriers between market and financial intermediation, the JSIC Report advocates broad measures designed to severely circumscribe entry of non-financial firms into market intermediation activities. To the extent that the regulatory objective of restricting entry is to ensure investor protection, presumably this could

be achieved by blanket registration requirements, with applicable Regulations tailored to the nature and proposed activities of potential entrants.

It should be noted that all market intermediaries, including those who rely upon exemptions, are subject to the regulatory jurisdiction of the Commission by virtue of the Commission's power to order that any or all of the exemptions do not apply to a person where, in its opinion, such action would be in the public interest. The issue then is how, rather than whether, to regulate.

The basis for the JSIC Report's contention that institutional investors require further protection (and, as a result, should bear additional transaction costs) is not clear. The Commission would welcome comment from those who purchase securities sold pursuant to the exemptions as to the demand for such additional regulation. To the extent such demand may exist, or the need for additional investor protection otherwise demonstrated, the Commission would appreciate analysis of the appropriate regulatory instruments. Such comments might extend to the suitability of regulations governing existing registrants. For example, the JSIC Report cites solvency regulation (i.e. regulatory capital requirements and membership in the National Contingency Fund) as one of the protections unavailable to those dealing with unregistered firms in reliance on exemptions. The Commission would welcome comment on the efficacy of the National Contingency Fund and other elements of the present regulatory requirements in the face of a rapidly evolving financial services sector.

If the primary concern of the JSIC is to preclude indirect entry of financial intermediaries into market intermediation activities, through affiliations or otherwise, presumably more specific regulatory instruments could be devised. The same principle applies to the other policy objectives noted in the JSIC Report, including competitive "inequalities".

Given the pace of change, questions as to whether there is a "level playing field" or whether competition is "fair" are difficult to determine. Moreover, efforts to establish "fairness" by legislation or regulation could easily result in ossification and ineffeciency. Consumers of financial services have little or no vested interest in the division of functions in the financial services sector per se. Rather, they are concerned primarily, perhaps exclusively, with receiving the best service possible and, for any given quality of service, the lowest price.

The JSIC Report does not attempt to quantify the costs of the regulatory requirements imposed on registrants, nor does it point to specific instances where such requirements have put registrants at a material competitive disadvantage to unregulated intermediaries. Others have suggested that the major competitive disadvantage suffered by the Canadian securities industry is the existence of ownership restrictions. Insofar as the JSIC Report recommends the broader application of such restrictions, and other regulations, it would appear to entail substantial additional costs.

It is not clear that the ownership restrictions presently imposed by self-regulatory organizations and which the JSIC would have the Commission adopt by regulation are the "least restrictive necessary to attain the desired effects". For example, the New York Stock Exchange only requires approval of any person owning greater than 25% of a registrant. The ability to separate ownership from effective management of a firm does not appear to be reflected in the JSIC recommendations. The Commission would welcome comment on whether measures designed to control the suitability of employees and directors might suffice.

B. Separation of Functions

As noted in the JSIC Report, the Commission has recently articulated its views concerning the desirability of protecting certain functions of market and financial intermediaries. Notwithstanding the constitutional concerns noted in the JSIC Report, the Commission has been able to implement policies and regulatory requirements in furtherance thereof.

In addition to avoiding potential conflicts of interest problems, guarding against undue concentration has traditionally been posed as a major regulatory objective of restricting entry, directly or indirectly, of financial intermediaries to market intermediation activities. The uncertainty that currently attends the market delineation process challenges the ability to utilize traditional concepts of competition regulation to measure or prevent excess concentration, either in specific markets or in the aggregate. Because of the fungibility of funds and flexibility of financial markets, it has and will continue to be relatively easy for regulated institutions to create innovative new instruments and develop other means to avoid regulations when they restrict profit opportunities. Alternatively, binding regulations create incentives for less regulated institutions to evolve effective substitutes for the more heavily regulated services.

The JSIC Report's endorsement of networking arrangements is consistent with the position previously taken by the Commission. However, the recommendation that such arrangements be reviewed on a case-by-case basis poses fundamental procedural problems. Moreover, the recommendation that responsibility for such reviews be undertaken by the self-regulatory organizations, as well as the Commission, raises basic concerns as to the appropriate role of self-regulation in the securities industry.

C. Separation of Markets

Given the relative size of Canada's economy and our proximity to the United States, concerns about undue foreign domination are a continuing element in any economic policy discussion. Indeed, the integrative (as opposed to insulating) forces generally at work in the financial markets facilitate a smoother and readier international transmission of economic and financial disturbances. Closer integration of financial markets permits changes in economic and financial conditions to spread their effects from country to country more quickly. Such influences pose difficult policy questions for a country such as Canada, whose economy is particularly sensitive to such international pressures. It may be that the ability to regulate against "undue foreign domination" can only effectively be applied to the ability of our governments to regulate during a period of crisis. In such circumstances (e.g. the inability of government to conduct its own finances), it is generally agreed that prior regulatory reforms are easily reversible.

Concerns about undue foreign domination are generally unrelated to the reasons why outside participants would like to enter the Canadian market and to the effect of their entry. It should also be noted that such entry often fosters international trade and serves to strengthen, rather than weaken, the domestic economy. Certainly it appears that the ability of non-resident firms to rely upon registration exemptions has, to date, contributed additional liquidity, service competition and product innovation to Canadian issuers and institutional investors.

The JSIC Report notes that the primary objective of non-resident entry restrictions must be to preclude non-residents from acquiring control of Canadian securities firms not now controlled by them. Would other regulatory models, such as the Bank Act model of restricted entry, merit consideration? Would activity restrictions suffice to satisfy the regulatory objectives noted in the JSIC Report? Alternatively, would a case-by-case approach (such as is administered by the Foreign Investment Review Agency) be appropriate?

The JSIC Report expresses concern that reliance on the registration exemptions tends to apply to trades involving institutions and "accentuates the negative impact on retail investors" (through increasing institutionalization). Presumably, such institutionalization is primarily a factor of other, unrelated, economic policies. It is not clear that the provision of additional services to institutional investors detracts from the services available to retail investors or, for that matter, that the two classes of investors make use of similar services or interact in the same markets. Nor is it clear how denial of the private placement exemption to retail investors dealing with non-resident firms, recommended in the JSIC Report, advances the interests of such investors.

IV. RELATED ISSUES

In addition to its primary recommendations, the JSIC Report addresses a number of other concerns raised by the Commission in its press release and preliminary issues paper. The JSIC Report itself raises certain additional concerns in response to which the Commission would welcome comment.

A. Domestic Securities Industry Capital

The JSIC considered the capital position of the Canadian securities industry, the adequacy of existing sources of capital to meet ongoing needs and the ability of firms to deal with equity turnover in view of the existing ownership restrictions. In each instance, the JSIC Report concludes that the existing regulatory framework, subject to the revisions proposed by the JSIC will enable the industry to be well financed and well able to meet its ongoing responsibilities. The data collected by the JSIC albeit limited, supports this position.

The Commission remains concerned, however, with the ability and incentive of the domestic industry to utilize capital creatively. To what extent does insulation from competitive pressures reduce the incentive to be innovative and take risks that, in the long run, would strengthen the position of the industry, both domestically and abroad? In addition, the data presented in the JSIC Report appears to relate primarily to category "A" firms (i.e. the largest firms in the industry). To the extent that access to capital may be a problem, the Commission is concerned that it would more likely arise with respect to medium-sized or smaller securities firms.

B. Advisers

By imposing non-resident ownership restrictions through denial of registration, the existing regulations have restricted the entry of non-resident investment advisers, as well as non-resident brokers and dealers. The policy rationale for such restrictions (and the scope of the registration requirement) was never clearly articulated and increasing demand for non-resident investment advice has led to the commitment of considerable Commission resources in considering applications for discretionary relief. The Commission would welcome comment on whether such restrictions are necessary or desirable. Should the regulatory model proposed by the JSIC be extended to apply to advisers?

C. Participation of Canadian Securities Firms in International Securities Markets

The JSIC Report recommends that the only significant constraint that should be imposed on the activities of a Canadian securities firm operating outside Canada in any endeavor permitted by the local laws is to prohibit financial commitments such as guarantees of the obligations of foreign affiliates. The Commission would appreciate further elaboration as to the efficacy of such a model. For example, should ownership restrictions or regulatory capital requirements be imposed on the holding company? Should the commitment of capital from the registrant to the holding company be monitored by the Commission or self-regulatory organizations?

D. Mutual Funds

As with investment advisers, the effect of the non-resident ownership restrictions extends to foreign mutual funds. The Investment Funds Institute of Canada has indicated to the Commission that it would not object to the entry of foreign mutual funds so long as the regulatory requirements complied with by investment funds distributed in Ontario and managed by Canadians are complied with by all non-resident investment funds so permitted to distribute their shares or units in Ontario. The Institute also recommends that the Commission should monitor on an ongoing basis the actual cumulative impact of any permitted entry of foreign investment funds into the Ontario market so that it will be in a position to diminish the number of exemptions granted, discontinue the granting of exemptions or withdraw previously granted exemptions if it should become evident that the achievement of the non-resident ownership policy is actually being negatively affected. The Commission would be interested in comments as to whether the relaxation of entry

restrictions in this manner, both with respect to investment funds and, perhaps, more generally, would be desirable.

V. REQUEST FOR COMMENTS AND PROPOSALS

Copies of the JSIC Report are available on request from the stock exchanges or the Investment Dealers Association of Canada. The Commission intends to convene public hearings commencing on November 5, 1984 to consider the issues raised in this Notice and in the Commission's preliminary issues paper, including uniformity of regulation, and the responses made by interested persons, including the JSIC. To facilitate informed participation at that hearing, submissions must be received by the Commission on or prior to October 26, 1984. All submissions will be available for inspection at the Commission and, immediately following October 26, bound copies of all submissions may be purchased at a price which will reflect the Commission's printing costs by contacting the Secretary of the Commission. Those desiring to participate in the public hearings must so indicate by October 26, 1984. Further details concerning the structure of the public hearings will be published in the O.S.C. Bulletin in due course.

Commission counsel do not anticipate advocating a particular view at the public hearing or in their written submissions. Instead, they intend to present the Commission with an analysis of alternative regulatory models, of which the JSIC proposals will be one. It is their desire to ensure that the Commission is provided with the views of a broad range of market participants and users. To this end, Commission counsel would be pleased to meet with interested parties to review any concerns and assist them in the preparation of their submissions to the Commission. Interested parties are encouraged to contact Edward Waitzer (869-5587) or John Stransman (869-5626), Stikeman, Elliott, Suite 1400, P.O. Box 85, Commerce Court West, Toronto, Ontario, M5L 1B9 or Harry Malcolmson (963-0221), Ontario Securities Commission, Suite 1800, P.O. Box 55, 20 Queen Street West, Toronto, Ontario, M5H 3S8.

The Commission will provide copies of all submissions received by it to each of the other Canadian securities administrators and is in the process of conferring with them as to their interest in participating in this policy review.

Appendix 6

LIST OF PERSONS AND COMPANIES WHO MADE SUBMISSION TO THE ONTARIO SECURITIES COMMISSION IN RESPECT OF THE SECURITIES INDUSTRY REVIEW

CANADIAN INVESTMENT DEALERS

1. Regulation and Ownership of Market Intermediaries in Canada - Report of the Joint Securities Industry Committee on behalf of the Alberta, Montreal, Toronto and Vancouver Stock Exchanges and the Investment Dealers Association of Canada. September 19, 1984.

2. Supplementary Report of the Joint Securities Industry Committee on behalf of the Alberta, Montreal, Toronto and Vancouver Stock Exchanges and the Investment Dealers Association of Canada. November 2, 1984.
Submitted by Tory, Tory, DesLauriers & Binnington (Richard J. Balfour).

3. Midland Doherty Limited - Regulation and Ownership of Market Intermediaries in Canada. October 24, 1984.

4. Gardiner, Watson Limited on The Securities Industry Policy Review. November 5, 1984.
Submitted by McCarthy & McCarthy (V.P. Alboini).

5. Bache Securities Inc. - Submission to the Ontario Securities Commission in Respect of its Policy Review of the Regulations Governing the Ownership and Registration of Securities Firms. November 5, 1984.
Submitted by Osler, Hoskin & Harcourt (F.R. Allen).

6. McLeod Young Weir Limited - Regulation and its Effect on the Competitive Position of the Canadian Securities Industry in Domestic and International Financial Markets. November 5, 1984.
Submitted by Davies, Ward & Beck (Garfield Emerson).

7. Merrill Lynch Canada Inc. - Submission to the Ontario Securities Commission in Respect of its Policy Review: Competitive Position of the Securities Industry in Domestic and International Financial Markets. November, 1984

CANADIAN INVESTMENT DEALERS (Cont'd)

8. Gordon Capital Corporation - Submission with respect to Policy Review: Competitive Position of the Securities Industry in Domestic and International Financial Markets; Regulation: A Security Blanket or Strait-Jacket? November, 1984.
Submitted by Davies, Ward & Beck (Thomas I.A. Allen, Q.C.).

9. First Marathon Securities Limited. November 7, 1984.

NON RESIDENT DEALERS

10. Morgan Stanley Canada Limited. November 6, 1984.
Submitted by McCarthy & McCarthy (Rene Sorell).

11. Securities Industry Association. November 5, 1984.
Submitted by McCarthy & McCarthy (V.P. Alboini).

12. Thomson McKinnon Securities Inc. November 5, 1984.
Submitted by Osler, Hoskin & Harcourt.

13. Merrill Lynch Capital Markets. November 5, 1984.

14. Drexel Burnham Lambert Incorporated. November 2, 1984.

15. First Boston Canada Limited. November 5, 1984.
Submitted by McCarthy & McCarthy (Rene Sorell).

16. Shearson Lehman/American Express Inc. November 1, 1984.

17. Salomon Brothers Inc. November 5, 1984.

18. Goldman, Sachs & Co. November 5, 1984

19. The Charles Schwab Corporation. November 6, 1984.
Submitted by McCarthy & McCarthy (V.P. Alboini).

NON RESIDENT DEALERS

20. S.G. Warburg & Co. Ltd. - Submission with respect to regulation and ownership of market intermediaries in Canada. November 6, 1984.

21. CIBC Limited. November 6, 1984.

22. The Nomura Securities Co., Ltd. November 5, 1984.

23. Daiwa Securities Co. Ltd. November 5, 1984.

24. The Nikko Securities Co., Ltd., Toronto Representative Office. November 5, 1984.
Submitted by Fasken & Calvin (C. L. Sugiyama).

FINANCIAL INSTITUTIONS

25. The Prudential Assurance Company Limited. November 1, 1984.

26. Metropolitan Life Insurance Company. November 5, 1984.
Submitted by Blake, Cassels & Graydon.

27. Canadian Life and Health Insurance Association Inc. - Securities Industry Policy Review of Foreign Ownership Restrictions on Advisor and Mutual Fund Dealer Registrations. November 5, 1984.

28. Bank of Montreal. October 25, 1984.

29. The Canadian Bankers' Association. - The Competitive Position of the Securities Industry in Domestic and International Financial Markets. November 6, 1984.

30. Executive Compensation Consultants Limited. November 5, 1984.

31. Mastercraft Development Corporation. November 5, 1984. Submitted by McCarthy & McCarthy (V.P. Alboini).

32. Committee on Legislation and Regulation, Ontario Chapter, Canadian Association of Financial Planners. October 31, 1984.

33. FEI Canada, Corporate Finance Committee. November 5, 1984.

34. Great Lakes Group Inc. - Corporate Profile. November 6, 1984.

35. The Permanent Commercial Limited. October 26, 1984.

36. Prospectors and Developers Association. November 2, 1984.

37. The Investment Funds Institute of Canada. November 6, 1984.

38. J.F. (Rick) Durst. November 7, 1984.

39. Discount Corporation of New York (Canada) Ltd. Dated November 7, 1984.

40. Submission by the Director of Investigation and Research of the Combines Investigations Act to the Ontario Securities Commission on the Issue of Regulation and Ownership of Market Intermediaries in Canada. November 7, 1984.

41. Thomas J. Courchene - "A Really Secure Industry or A Real Securities Industry". November 22, 1984.

42. Domick Corporation of Canada Limited. December 7, 1984.

43. Orion Royal Bank Limited. November 29, 1984.

44. Royal Bank of Canada - "Financial Industry Restructuring - What's in it for Canadians?" November 27, 1984.

**CLOSING SUBMISSIONS
TO THE
ONTARIO SECURITIES COMMISSION
IN RESPECT OF ITS
SECURITIES INDUSTRY REVIEW**

1. Dominick Corporation of Canada Limited (Submitted by Ralph Carter, President). December 7, 1984.

2. The Canadian Bankers' Association (Submitted by Anthony R. Guglielmin, Research Officer). December 17, 1984.

3. Metropolitan Life Insurance Company (Submitted by W.M.H. Grover of Blake, Cassels and Graydon). December 14, 1984.

4. Salomon Brothers Inc. (Submitted by W.M.H. Grover of Blake, Cassels & Graydon). December 17, 1984.

5. Templeton Growth Fund, Ltd. (Submitted by Bruce S. MacGowan, C.A., Treasurer). December 17, 1984.

6. Daiwa Securities Co. Ltd. (Submitted by H. Nomura). December 17, 1984.

7. Sharwood and Company Limited (Submitted by Gordon R. Sharwood). December 20, 1984.

8. The Director of Investigation and Research Combines Investigation Act. December 1984.

9. **CONFIDENTIAL BRIEF** on Concentration of Power - The Canadian Bankers' Association. December 24, 1984.

10. Gardiner Group Stockbrokers Inc. (Submitted by Stanley J. Deudney, President). January 3, 1985.

Appendix 7

SCHEDULE OF APPEARANCES

BEFORE THE

SECURITIES INDUSTRY REVIEW

DATE	NOVEMBER 19	NOVEMBER 20	NOVEMBER 21	NOVEMBER 22	NOVEMBER 23
10:00 a.m.	OSC Counsel	Gordon Capital	Merrill Lynch		Investment Funds Institute
2:00 p.m.	JSIC		Gardiner, Watson First Marathon	Discount Corp. Rick Durst Prospectors and Developers Assoc.	
DATE	NOVEMBER 26	NOVEMBER 27	NOVEMBER 28	NOVEMBER 29	NOVEMBER 30
10:00 a.m.	Financial Executives Institute		JSIC	CBA	JSIC
2:00 p.m.	Bache Securities		T. Courchene Cdn. Association of Financial Planners	Royal Bank Orion Royal Bank	JSIC
DATE	DECEMBER 3	DECEMBER 4	DECEMBER 5	DECEMBER 6	DECEMBER 7
10:00 a.m.	McLeod, Young Weir	CIBC Limited Securities Industry Association		Merrill Lynch Bache Securities	JSIC
2:00 p.m.	JSIC	Director of Investigation & Research, CIA	Morgan Stanley First Boston	JSIC	Nil
DATE	DECEMBER 10	DECEMBER 11	DECEMBER 12	DECEMBER 13	DECEMBER 14
10:00 a.m.	OSC Counsel				
2:00 p.m.					

(Revised December 5, 1984)

APPENDIX 8

SUMMARY OF THE CURRENT REGULATORY FRAMEWORK
FOR THE OWNERSHIP OF SECURITIES FIRMS

1. THE REGISTRATION REQUIREMENTS

1.1 Regulation by Registration. The Securities Act (Ontario) (the "Act") regulates the securities industry in Ontario, among other ways, by prohibiting a person from carrying on certain elements of the business without being registered under the Act.

1.2 Dealers. To trade in a security, a person must be registered as a dealer, or as a salesman, partner or officer of a registered dealer (clause 24(1)(a)). The term "trade" is defined to include any disposition of a security for valuable consideration, any participation in a transaction on the floor of an exhcnage and any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of a trade.

1.3 Underwriters. In order to act as an underwriter, a person must be registered as such under the Act (clause 24(1)(b)) and the term "underwriter" is defined to mean a person who as principal agrees to buy securities with a view to distribution, or who as agent offers for sale or sells securities in connection with a distribution. A distribution refers to a trade in securities of an issuer from treasury or from the holding of a 20% shareholder.

1.4 Advisers. Lastly, in order to engage in the business of advising others as to the investing in or the buying or selling of securities, a person must be registered as an adviser under the Act (clause 24(1)(b)).

1.5 Members of Self Regulatory Organizations. Both the dealer and adviser classes of registration are divided into a number of categories. Included among the categories of dealer are brokers who are registered to trade in securities and are members of The Toronto Stock Exchange ("TSE") and investment dealers who are registered to trade in securities and are members of the Ontario District of the Investment Dealers Association of Canada ("IDA").

2. OWNERSHIP RESTRICTIONS

2.1 Conditions of Registration. The Regulations under the Act (the "Regulations") impose a number of conditions on the registrations granted thereunder. Included among these are restrictions on the ownerhsip of securities of registrants by non-residents.

2.2 Non-Resident Ownership. Registration and renewal of registration is conditioned upon the applicant being a resident, and non-residents and their associates and affiliates not having a beneficial interest in or exercising control or direction over, individually, more than 10% of the issued securities of any class of the dealer and, in the aggregate, not more than 25% of the issued securities of any class (Regulation; section 133). In addition, the By-laws of the TSE and IDA (the "SROs") impose substantially similar restrictions on the ownership of securities of their member firms by non-registrants.

2.3 Non-Industry Investors (Including Financial Institutions) The By-laws of SROs (but not the Regulations) also provide that no non-industry investor (being anyone other than a partner, officer or employee of a member firm) may own securities of the member firm carrying more than 10% of the voting rights or equity participation carried by all outstanding securities of the member firm. These restrictions would apply equally to investors which are financial institutions.

2.4 Public Ownership of Securities Firms. Finally, Ontario Securities Commission Policy Statement 4.1 provides that registrants may distribute their securities to the public provided that, except with the consent of the Commission and either or both of the SRO's if the registrant is a member of either or both, no new investor who is an officer, or any associate or affiliate of the invesor, shall have a beneficial interest in or exercise control or direction over more than 10% of any issued class or combination of issued classes of voting or participating securities of the registrant.

3. THE EXEMPT MARKET

3.1 Exemptions from Registration as a Dealer. As referred to above, the Act imposes the registration requirement, as a general rule, upon all persons wishing to trade in securities or to act as an underwriter or adviser. There is, however, an entire system of exemptions from the registration requirement for trading in securities which parallels the system of exemptions from the prospectus requirement for distributions of securities. The registration exemptions are divided into exemptions for specific types of trades and exemptions for trades in specific types of securities. Generally, the exemptions from the registration requirement are available because to the nature of the transaction, the securities or the purchaser, it is considered unnecessary to provide the purchaser with the kind of investor protection which flows from full disclosure in the prospectus and capital, business management and proficiency requirements imposed on registered dealers.

3.2 Exemptions for Certain Trades. There are registration exemptions in respect of 23 specified trades (subsection 34(1), including trades to facilitate incorporation and organization of the issuer, trades involved in take-over, amalgamation and stock dividends and trades to employees. Three of the most important exemptions are:

(i) trades to financial institutions and governments who purchase as principals but not as underwriters,

(ii) trades to purchasers (other than individuals) recognized by the Commission as exempt purchasers, and

(iii) trades where the purchaser purchases as principal and the security has an aggregate acquisition cost of at least $97,000.

Exemptions parallel to these are also provided from the prospectus requirements of the Act.

3.3 Exemptions for Certain Securities. The Act as well provides provides exemptions from the registration requirement for trades in some 15 different types of securities irrespective of the nature of the transaction or the purchaser (subsection 34(2)). Of particular importance are the exemptions for:

(i) debt securities of domestic and foreign governments, banks, loan and trust corporations and insurance companies; and

(ii) negotiable promissory notes or commercial paper maturing within one year, and if purchased by an individual, in a principal amount of not less than $50,000.

Accordingly, if a securities firm's business is limited to exempt trades or trades in exempt securities, there is no obligation to obtain a registration and the ownership restrictions attaching thereto have no application to the firm.

3.4 Exemptions from Registration as an Underwriter. The Act and Regulations also provide exemptions from the registration requirements for underwriters and advisers.

Section 141 of the Regulations provides that registration is not required to act as an underwriter in respect of either a trade referred to in subsection 34(1) of the Act or a security referred to in subsection 34(2) of the Act.

Furthermore, the definition of an underwriter in the Act (paragraph 43 of subsection 1(1)) specifically excludes various persons from being considered as underwriters, including:

(i) a person whose interest in the transaction is limited to receiving the usual and customary distributor's or seller's commission payable by an underwriter or issuer; and

(ii) a bank with respect to debt securities issued by a domestic or foreign government or a financial institution.

3.5 Exemption from Registration as an Adviser. Finally, banks, trust companies, insurance companies, registered dealers, various professionals and journalists are exempt from the registration requirement for acting as advisers where the performance of the service as an adviser is solely incidental to their principal business or occupation.

4. SPECIAL CATEGORIES OF REGISTRATION

4.1 Registration for Financial Institutions. Two special categories of registration as a dealer have been created for particular circumstances which are exceptions in practice to the Government policy on the segregation of the "four pillars" of the financial services industry. These are the Type II registration and the registration as an order execution access dealer ("Access Dealers").

4.2 Type II Registration. Type II registration is available to banks which, upon registration, may solicit the purchase or sale of its securities or those of associated issuers (subject to sales and advertising restrictions) and securities in the distribution of which the bank participates as a member of the selling group (if they are identified to customers only through lists available on their request). Type II registrants may also, within limited parameters, give advice as to recommended securities where the customer approaches the bank in this regard.

4.3 Order Execution Access Dealers. Another special category of registration as a dealer is both available and mandatory for Access Dealers who provide a service pursuant to which a customer places an order to purchase or sell securities for execution by another registered dealer or for execution outside Ontario. Individual conditions of registration are settled with each Access Dealer, all of which prohibit the Access Dealer from giving investment advice and making tied arrangements with other securities dealers.

APPENDIX 9

JSIC Definition of Industry Investor

12b. "industry investor" means, in respect of any dealer or of any holding company of any dealer, any of the following,

i. the dealer's full time officers and employees, or the full time officers and employees of an affiliate of the dealer that carries on securities related activities provided that such officers and employees of the affiliate devote their full time to the securities related activities,

ii. spouses of individuals referred to in subparagraph i,

iii. an investment company where,

A. a majority of each class of the voting securities thereof is beneficially owned by individuals referred to in subparagraph i, and

B. all interests in all other outstanding voting or outstanding participating securities of the investment company are beneficially owned by industry investors with respect to the particular dealer,

iv. a family trust established and maintained for the benefit of the individuals referred to in subparagraph i and ii or their children where,

A. full direction and control of the family trust, including, without limitation, its investment portfolio and the exercise of voting and other rights attached to the instruments and securities contained in the investment portfolio, are maintained by individuals referred to in subparagraph i or ii, and

B. all beneficiaries of the family trust are individuals referred to in subparagraph i or ii or their children, or are industry investors with respect to the particular dealer,

v. a registered retirement savings plan established under the Income Tax Act (Canada) by an individual referred to in subparagraph i or ii if control over the investment policy of the registered retirement savings plan is held by that individual and if no other person has any beneficial interest in the registered retirement savings plan,

vi. a pension fund established by the dealer for its officers and employees if the pension fund is organized so that full power over its investment portfolio and the exercise of voting and other rights attached to instruments and securities contained in the investment portfolio is held by individuals referred to in subparagraph i,

vii. the estate of an individual referred to in subparagraph i or ii for a period of one year after the death of such individual or such longer period as may be permitted by the Director or the applicable self-regulatory organization of which the dealer is a member, if any, if notice of the longer period has been given to the Director and he has not objected thereto,

viii. any investor referred to in subparagraph i, ii, iii, iv or v for a period of 90 days or such longer period as the Director (or the applicable self-regulatory organization of which the dealer is a member, if any, if notice of the longer period has been given to the Director and he has not objected thereto) may permit after the individual who, in the case of subparagraph i, is the investor or, in the case of subparagraph ii, iii, iv or v, is the person through whom the industry investor qualifies as such, is no longer in the employment of the dealer,

but any of the foregoing is an industry investor only if an approval for purposes of this definition has been given, and not withdrawn, by the board of directors or partners of the dealer and the Director or the applicable self-regulatory organization of which the dealer is a member, if any, if notice of such approval by the board of directors or partners has been given to the Director and he has not objected thereto;

APPENDIX 10

Excerpt from Chapter 4 of the Discount Access Report of the Ontario Securities Commission dated October, 1983 relating to permitted activities of banks under the Bank Act (Canada) and the Securities Act (Ontario).

The Bank Act Acknowledges the Core Function of the Securities Industry

4.10 Before addressing the concerns discussed in Part III of this Report we would like to describe the support which is given to our analysis of the core function of the securities industry by the terms of both the Bank Act and the Securities Act. As securities regulators and as interpreters of this legislation for purposes of our Report we have been impressed with the rather neat fit between these two statutes, both of which underwent a process of amendment in the late 1970s.

4.11 The amendments to the Bank Act reflected the intention of Parliament, anticipated in the White Paper on Canadian banking legislation issued in August 1976, to clarify the role of the banks in the securities business and particularly in the sale of corporate securities. The White Paper provides:

> "The securities industry, by underwriting new issues and by maintaining secondary markets and consequently liquidity for outstanding securities, plays a significant role in our capital markets. It is important that it should continue to be a strong segment of these markets and that the corporate sector should continue to have a choice of sources for funds, that is, the banking sector or the public through the underwriting facilities of an independent dealer. To help ensure this choice, and taking into account conflict of interest concerns and possible undue concentration of power, it is proposed to define more precisely the role of banks in the sale of corporate securities".

The Banks and Banking Law Revision Act, 1980 did just that.

4.12 The general power of banks to carry on the business of banking as it relates to securities is set out in section 173(1)(c) and (h) of the Bank Act:

> "A bank may engage in and carry on such business generally as appertains to the business of banking and, without limiting the generality of the foregoing may ...
>
> (c) acquire, deal in, discount and lend money and make advances on the security of, and take as security for any loan or advance made by the bank or any debt or liability to the bank, bills of exchange, promissory notes and other negotiable instruments, coin, gold and silver bullion and securities; ...
>
> (h) act as a financial agent for any person in the performance of non-discretionary functions in relation to securities and financial transactions but not as agent or attorney in the sale or purchase of any property other than securities and not in the capacity of a general agent ...."

4.13 The Bank Act and the Securities Act address in turn the role of the banks in the secondary markets, their capacity to give investment advice and the involvement of banks in underwriting.

Secondary Market Activities

4.14 The Bank Act divides the regulation of secondary market activities between "equity securities" and "bonds, debentures and other evidences of indebtedness". In the Bank Act "equity securities" means shares of any class of a corporation and any rights in connection therewith. In Section 190(3) and (4) a bank has the following power:

> "(3) Notwithstanding paragraph 173(1)(c) and except as otherwise provided in this Act, a bank shall not in Canada buy or sell equity securities.
>
> (4) Notwithstanding subsection (3), a bank may
>
> (a) ... as principal, buy and sell equity securities but where it buys or sells equity securities otherwise than for or from its investment portfolio, the purchase or sale shall be effected by a broker or dealer who is not a bank or an employee of a bank and who is authorized by law to engage in such transactions with members of the public;
>
> (b) act as agent of a vendor or purchaser of equity securities if the sale or purchase is effected by a broker or dealer referred to in paragraph (a) ...."

4.15 This power under the Bank Act coincides with the exemption from registration available to banks in section 34(1)11. of the Securities Act, the unsolicited trade exemption. A bank carrying

on activities beyond the terms of the exemption would be subject to the registration requirements of the Securities Act.

4.16 With respect to debt securities the Bank Act provides:

> "(2) a bank may, as principal or agent, buy and sell ...
>
> (b) bonds, debentures and other evidences of indebtedness."

4.17 In the Bank Act "bond, debentures and other evidences of indebtedness" includes, while they remain unconverted, debt securities that are convertible into equity securities. To trade debt securities under the Securities Act banks generally rely on the unsolicited trade exemption and the general exemption in section 34(2)1. of the Securities Act for government debt securities. A bank may also rely upon an exemption in the regulations of the Securities Act for a trade in a bond or debenture by way of an unsolicited order given to a bank, provided the bank is acting as principal and the bond or debenture is acquired by the bank from, or sold by the bank to, a registered dealer. There is also an exemption in section 34(1)3.i. for a trade where the bank purchases as principal, but not as underwriter, but this exemption is intended to address the question of banks investing as

principals. This latter exemption is also available to trust companies. Accordingly, in general terms under the Securities Act, a bank may trade bonds with dealers on an unsolicited basis and may trade government bonds without constraints as to solicitation.

Giving Investment Advice

4.18 Section 174(2)(c) of the Bank Act provides:

> "...a bank shall not, directly or indirectly, ...
>
> (c) except in respect of any bank guarantee or pension fund, hold itself out as engaging in or engage in portfolio management or investment counselling in Canada ...."

4.19 Under the Bank Act "investment counselling" means the "offering of advice to, or advising of, other persons on the advisability of investing in, purchasing or selling securities whether or not such other persons are ascertained but does not include the giving of such advice on a casual basis for no monetary consideration." The term "portfolio management" means the "investment or control, in any way that involves an element of discretionary judgement by the person engaging therein, of money or securities that

(a) are not owned by that person, or

(b) are not moneys deposited with that person in the ordinary course of that person's business."

4.20 This constraint in the Bank Act fits with the provision in the Securities Act that registration as an adviser is not required to be obtained by a bank "...where the performance of the service as an adviser is solely incidental to their principal business or occupation ...."

Underwriting

4.21 The Bank Act carefully defines permissible underwriting activities for banks. Section 190(5) of the Bank Act provides:

"A bank shall not in Canada act as an underwriter of securities or as a member of a selling group except

(a) in respect of bonds, debentures and other evidences of indebtedness of the bank or

(specified government, government public utility and government agency debt) ...

(b) as a member of a selling group in connection with an underwriting of securities issued by a corporation other than a bank".

The term "underwriter" is defined in the Bank Act in substantially the same terms as it is defined in the Securities Act. The Securities Act, in the definition of "underwriter", exempts banks from the underwriter registration requirements in respect of government securities.

4.22 A bank wishing to act as a member of a selling group in a corporate underwriting would be obligated to seek registration as a dealer under the Securities Act unless other registration exemptions, such as the unsolicited trade exemption, were available.

4.23 Section 190(7) of the Bank Act limits a bank's involvement in a private placement to securities which a bank can underwrite. Section 141 of the regulations to the Securities Act provides a general exemption from the underwriter requirements for the trades described in section 34(1) and for trades in the securities described in section 34(2) of the Securities Act. This exemption could be combined, perhaps with the private placement exemption in section 34(1)5. of the Securities Act, to enable banks to act as agents in connection with private placements. This use is unintended and is addressed in our recommendations.

4.24 To ensure that a bank is not giving advice in respect of any particular security section 190(6) of the Bank Act provides:

> "A bank may hold itself out in Canada to the public as a buyer and seller of securities but shall not in so doing promote the sale of any particular security other than (government, certain government agency and public utility debt securities) ..."

4.25 It is fairly clear then that the Bank Act defines a number of activities with securities overtones as banking and the Securities Act generally accepts the definitions in the Bank Act by granting registration exemptions to the banks in respect of those activities. In summary a bank (i) can only trade in the secondary market in equity securities on an unsolicited basis through registered brokers, (ii) can trade government debt securities without registration, (iii) is precluded from giving advice in respect of securities, except on a casual basis for no monetary consideration (an activity which also appears to be exempt from the adviser registration requirements of the Securities Act) and (iv) is precluded from acting as an underwriter of corporate securities, but may act as a member of a selling group without registration under the Securities Act if its participation in the selling group is confined to filling orders from clients received on an unsolicited basis.

4.26 There is a clear recognition in both the Bank Act and the Securities Act that underwriting of new corporate securities or the distribution of such securities as an agent, the giving of investment advice and trading on behalf of clients in the secondary market, except on an unsolicited basis, are activities which are restricted to brokers and investment dealers. What is also interesting is that the comprehensive approach of the Bank Act to defining the permissible securities-related activities of banks, narrowed considerably the securities-related activities of the banks as they existed before the 1980 revision of the Bank Act. The evident thrust of the Bank Act is to constrain rather than enlarge the securities-related powers of banks.

4.27 To sum up this Part IV, it is the Commission's view that (i) the new issue business is the core function of the securities industry, (ii) essential to, and supportive of, this business is the distribution of securities, (iii) an essential element of such distribution is the solicitation of sales of securities, which can only be achieved by giving investment advice and (iv) the involvement of financial institutions in

providing discount access services does not materially impair the performance of the core function of the securities industry and the essential functions related to the core function. It will be apparent from our recommendations that the Commission will exercise its powers to ensure that the discharge of the core function by the securities industry will not be impaired.